Indiana Law Review

Volume 34 No. 2 2001

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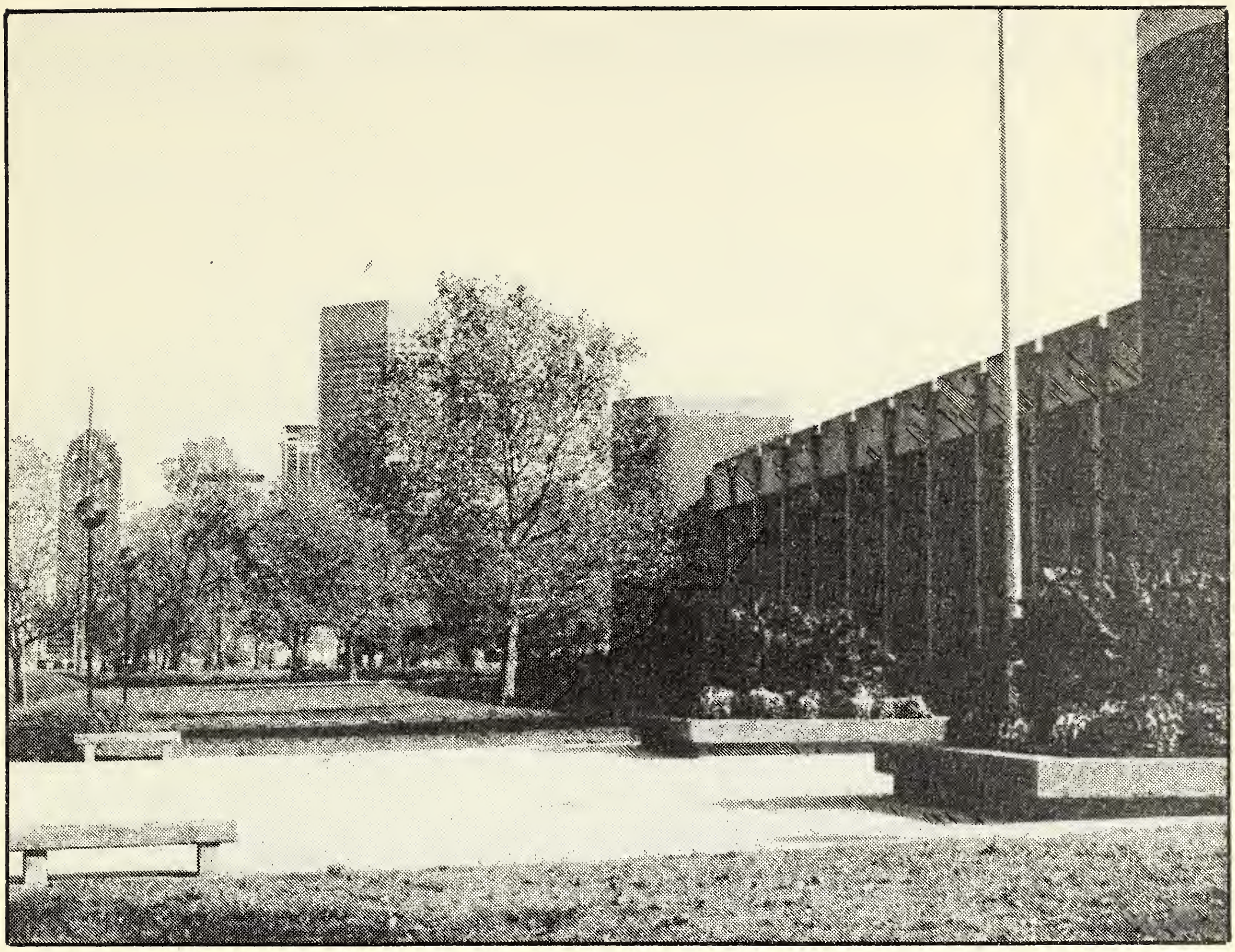

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JUNE STARR

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TRIBUTE

TRIBUTE TO PROFESSOR JUNE STARR

DAVID RAY PAPKE*

June Starr retired from the School of Law faculty during the summer of 2000. She joined the faculty as an Associate Professor of Law in 1994 and was promoted to Professor of Law shortly before her retirement. During her years in Indianapolis, Professor Starr taught large courses in the family law and environmental law areas as well as specialized seminars involving anthropology and the law, the law of children, and international law. Professor Starr enriched the School of Law in countless ways, and by reflecting at the time of her retirement on her major contributions, we might be better able to make those contributions a living part of the institution's future.

I. A SENSE OF ACADEMIC ADVENTURE

To begin with, Professor Starr brought to the School of Law a tremendous openness to and excitement regarding the full range of academic and intellectual experiences. Trained as a cultural anthropologist at Columbia University (M.A., 1961) and the University of California—Berkeley (Ph.D., 1970), she rose through the ranks to become a Full Professor of Anthropology at the State University of New York in Stony Brook. During leaves from Stony Brook, she served as a Fulbright Professor at the Indian Law Institute in New Delhi and at the Ankara Law School in Ankara, Turkey. From 1981-83, she was also a Professor of Sociology at the University of Rotterdam's Erasmus Law School in Holland. In these places and pursuits she participated in dialogues with a world community of scholars and thinkers.

In much the same way that Professor Starr reached from the United States to experiences in other parts of the world, she reached within the United States from her first discipline of anthropology to other paradigms and perspectives. She was one of the founding figures in the Law and Society Association, an umbrella organization for scholars in the social sciences with an interest in law and legal issues. Fortunately for the Indiana University School of Law—Indianapolis, Professor Starr found that the discipline of law in and of itself was of great interest. Hence, she spent a year in the Yale Law School's prestigious Law and

* R. Bruce Townsend Professor of Law, Indiana University School of Law—Indianapolis; Professor of Liberal Arts, Indiana University-Purdue University at Indianapolis. A.B., 1969, Harvard College; J.D., 1973, Yale Law School; Ph.D. in American Studies, 1984, University of Michigan.

Modernization Program and then earned degrees in law at Yale (M.S.L., 1990) and Stanford (J.D., 1992).

Professor Starr's amazing curiosity and ambitiousness led to a wealth of contacts, a good number of whom lectured at the School of Law during Professor Starr's years in Indianapolis. More fundamentally, she superbly represented the questing and exploring which can be the heart of academic life. She was an antidote to the tendency to stay at home, both physically and intellectually. She was our leading adventurer.

II. Contextual Jurisprudence

Not surprisingly given Professor Starr's abundance of international and interdisciplinary experiences, she developed a distinctive understanding of the law, and this understanding enlivened the School of Law. Stated simply, Professor Starr thought law was best understood in a cultural, political and historical context. Put in reverse terms, she gave little truck to the old idea that law should be understood as an autonomous discipline. Thinking of law as something existing merely onto itself, in her opinion, was something of a "false consciousness," one which might be seductive for a secular priesthood of practicing lawyers but one which could never produce critical and enduring thought about law.

Professor Starr's understanding of law is particularly evident in her scholarly publications. These include literally dozens of reviews, essays and articles as well as three superb book-length studies. Two of the books, *Dispute and Settlement in Rural Turkey: An Ethnography of Law* (1978) and *Law as Metaphor: From Islamic Courts to the Palace of Justice* (1992), established Professor Starr as the United States' leading expert on Turkish law and legal systems. The third book, *History and Power in the Study of Law* (1989, co-edited with Jane Collier), included Professor Starr's own work as well as that of a distinguished group of scholars. Any reader of these works can see clearly Starr's forceful intellect, her sensitivity to nuance and contradictions, and her boldness regarding law's cultural, political and historical characteristics.

Professor Starr, it should be underscored, brought her understanding of the law into her classrooms as well. Many professors fully appreciate the sociohistorical features of law in their private thought and publications but take the easier route of authoritatively serving up legal rules, corollaries and exceptions in their classes. But this was not Professor Starr's approach. She is to be commended for insisting *in the classroom* that great lawyers appreciate the ways law dwells within culture, politics and history. The great sociolegal jurists who helped dethrone formalist legal thought—Holmes, Cardozo, Brandeis—surely smiled down on Professor Starr as she taught.

III. Self-Reflection and Critique

When one has a spirit of academic adventure and when one appreciates law in contextual ways, it is perhaps inevitable that one will also stop to evaluate and appraise one's social situation. Professor Starr, we can note happily, was blessed with a knack for self-reflection. She had the ability and the willingness to

critique the sprawling edifice of legal education and the particular structure called the Indiana University School of Law—Indianapolis.

Day in and day out Professor Starr was a source of insight about our law school. In a friendly and constructive way, she told us what we did right and what we did wrong. She saw the faculty, student body, and administration in an especially bright light, and we all profited from her perceptions.

One case in point: Starr knew that all primate societies were complicated by "greybacks," that is, senior males of the species. More important than the grey hair growing on their upper-backs is the "greyback" tendency to fuss and fume, to fight over turf, and to cause a ruckus. Human "greybacks" have much in common with their counterparts among the chimps and gorillas, and the law school faculty has no shortage of "greybacks"—alas, the author of this tribute included.

IV. The Road Ahead

Since her retirement, Professor Starr has returned to the house she occupied during her years on the State University of New York at Stony Brook faculty. Built on a bluff overlooking the Long Island Sound, her home is truly beautiful and also in close proximity to her son, Turkish daughter-in-law and grandson, who live in Manhattan. Professor Starr is comfortable in her surroundings, and, as her recent legal actions involving the arbitrary conduct of local zoning officials suggest, she remains more active than the notion of retirement might imply.

Locally, we have to shout out with thankfulness that Professor Starr spent the latter stages of her academic career in Indianapolis. Her willingness to explore the full range of academic experiences, her contextual understanding of law, and her facility for self-reflection and critique enriched the Indiana University School of Law—Indianapolis more than words could ever express. We were incredibly fortunate to have this warm and wonderful woman in our midst, and in the years ahead, we will benefit by recalling what she kindly shared with us.

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ARTICLES

ERISA'S PREEMPTION CLAUSE: PROGRESS TOWARDS A MORE EQUITABLE PREEMPTION OF STATE LAWS

LARRY J. PITTMAN*

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INTRODUCTION

Health care expenditures consume a substantial portion of the gross national product of the United States.[1] In the 1980s, to curb escalating health care costs, both public and private purchasers of health care turned to managed care organizations for the arrangement and financing of health care.[2] These organizations used several managed care procedures to reduce health care costs, including prospective utilization review to evaluate the medical necessity of treatments and financial incentives to control physicians' treatment decisions.[3] Presently, approximately seventy-five percent of Americans who have health care protection from their employers obtain their benefits through managed care organizations.[4]

Managed care has been successful in reducing health care costs.[5] However, many consumers have joined in a backlash protest against managed care organizations and their cost cutting procedures.[6] This debate has centered around the fear that, in an effort to cut health care costs, managed care organizations use procedures and strategies that either cause or have the potential of causing a reduction in the quality of health care.[7] In response to such concerns, states have

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1. *See* Edward B. Hirshfeld et al., *Structuring Provider-Sponsored Organizations: The Legal and Regulatory Hurdles*, 20 J. LEGAL MED. 297, 299 (1999) (asserting that "[h]ealth care spending accounted for 7.1% of the gross national product in 1996, 9% in 1979, and nearly 14% in 1996. Some economists expect health care to account for almost 18% of the gross national product by 2005.").

2. *See e.g.*, Alice A. Noble & Troyen A. Brennan, *The Stages of Managed Care Regulation: Developing Better Rules*, 24 J. HEALTH POL. POL'Y & L. 1275 (1999) (discussing the development of managed care and state law regulation of managed care).

3. *See* William M. Sage, *Regulating Through Information: Disclosure Laws and American Health Care*, 99 COLUM. L. REV. 1701, 1704 n.5 (1999) (asserting that "[m]ost care management is accomplished using one or more of four basic mechanisms: financial incentives, direct review of service utilization, structural features that affect the availability of services, and the normative environment in which physicians work").

4. *See* Russell Korobkin, *The Efficiency of Managed Care "Patient Protection" Laws: Incomplete Contracts, Bounded Rationality, and Market Failure*, 85 CORNELL L. REV. 1, 5 (1999) (asserting that "[b]y 1995, nearly seventy-five percent of Americans with employer-provided private insurance, and more in some part of the country, received their medical care from [managed care organizations]").

5. *See* Korobkin, *supra* note 4, at 5 ("Although it is not clear whether the trend will be sustainable in the long run, the market penetration of managed care has reduced health care inflation in recent years.").

6. *See* Marc A. Rodwin & Atoz Okamoto, *Physicians' Conflicts of Interest in Japan and the United States: Lessons for the United States*, 25 J. HEALTH POL. POL'Y & L. 343, 367 (2000) ("Having rejected major health care reform during the first Clinton administration, public policy was laissez-faire and promoted the growth of for- profit health care and MCOs. The result: a public backlash and both state and federal regulation of managed care during Clinton's second term.").

7. *See* David A. Hyman, *Regulating Managed Care: What's Wrong with a Patient Bill of*

passed approximately one thousand different laws to protect consumers from managed care's perceived abuses,[8] including "any willing provider" laws, anti-gag clause laws, "maternity length-of-stay bills," "direct access" to emergency and specialist care laws, and laws regulating the deselection of physicians from preferred list of providers.[9] Similarly, the federal government has enacted several laws, including one allowing mothers to remain in the hospital at least forty-eight hours after child birth.[10] However, special interest groups have prevented the federal government from passing comprehensive national legislation to regulate managed care organizations and managed care strategies.[11]

Although states have more proactively regulated managed care organizations,[12] the Employment Retirement Income Security Act (ERISA) has been a substantial limitation on states' abilities to protect their citizen-employees.[13] This limitation is primarily effectuated through managed care organizations' use of ERISA's preemption clause to preempt state laws that attempt regulation of managed care organizations. For example, substantial uncertainty exists over whether, as a part of its protection of citizens from negligent medical decisions, a state like Texas can regulate the quality of medical decisions that a managed care organization makes during its utilization review process of granting or denying medical treatment.[14] The answer to this question, and other related questions regarding the types of state laws that are acceptable regulations of managed care organizations, primarily depends on federal courts' interpretations of ERISA's preemption clause. Issues surrounding ERISA's preemption of state health care laws are important because, in light of the federal government's special interest-induced paralysis, state governments appear to be the only real protectors of consumers against managed care abuses. Fortunately, recent Supreme Court and lower-level federal court decisions have, through their construction of ERISA's preemption clause, given more protection to state law regulation of managed care organizations and their cost-cutting strategies.

Part I discusses the relevant ERISA statutory provisions. Part II shows that the Court's decision in *New York State Conference of Blue Cross & Blue Shield*

Rights, 73 S. CAL. L. REV. 221, 241 (2000) ("This literature convincingly demonstrates that MCOs perform at least as well, and often better than fee-for-service health care.").

8. *See* Korobkin, *supra* note 4, at 2 (asserting that "[s]tate legislatures have enacted perhaps as many as 1000 patient protection laws nation wide").

9. *See generally* Noble & Brennan, *supra* note 2, at 1283-87.

10. *See* Korobkin, *supra* note 4, at 3.

11. *See id.* at 3-4 (discussing federal bills to regulate managed care organizations).

12. *See id.* at 2-4.

13. 29 U.S.C. § 1000 (1994). ERISA is applicable because a substantial number of employees obtain their health care benefits from their employers, thereby bringing them under ERISA's coverage.

14. *See generally* Corporate Health Ins., Inc. v. Tex. Dep't of Ins., 12 F. Supp. 2d 597 (S.D. Tex. 1998), *aff'd in part and rev'd in part*, 215 F.3d 526 (5th Cir. 2000), *and petition for cert. filed*, 69 U.S.L.W. 3317 (U.S. Oct. 24, 2000) (No. 00-665).

Plans v. Travelers Insurance Co.[15] is a shift in the Court's interpretation of ERISA's preemption clause, one that gives deference to states' police power regulations and that emphasizes ERISA's statutory objectives. Part III concludes that, despite a new approach to the interpretation of the preemption clause, much indeterminacy persists surrounding ERISA's preemption of state laws and lawsuits. Part IV connects the Court's decision in *Pegram v. Herdrich*[16] to an ERISA preemption analysis and shows how that case is an extension of the Court's efforts to narrow the scope of ERISA's preemption. Part V analyzes lower-level federal courts' application of the *Travelers* case to state law claims. Among other things, this part not only shows a narrowing of ERISA's preemption when courts find no preemption of state law claims challenging managed care organizations' negligent decisions when the organizations are acting as medical arrangers and providers, but Part V also shows that some courts continue to find preemption of state law claims that challenge managed care organizations' utilization review decisions. This part also explains how some courts deny ERISA's preemption of state lawsuits challenging the quality of provided medical benefits, but find preemption when the complaint is about either denied benefits or the quantity of benefits. Part VI discusses the future of ERISA's preemption of state laws and lawsuits, and it proposes a new approach to ERISA's preemption by offering the "equity preemption" concept.

I. Relevant Statutory Provisions

Several of ERISA's statutory provisions play an important part in the issues raised in this Article. For example, ERISA is applicable to employee welfare benefit plans that employers provide to their employees. In relevant part, section 1002(1)(A) of ERISA defines an employee welfare benefit plan as a plan that is maintained

> for the purpose of providing for its participants or their beneficiaries, through the purchase of insurance or otherwise, . . . medical, surgical, or hospital care or benefits, or benefits in the event of sickness, accident, disability, death or unemployment, or vacation benefits, apprenticeship or other training programs, or day care centers, scholarship funds, or prepaid legal services.[17]

This Article primarily involves ERISA plans that provide medical benefits to employees and their beneficiaries. These plans frequently arrange for medical care by entering into contracts with HMOs and other managed care organizations that assume the responsibility of paying for and providing necessary medical providers.[18]

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15. 514 U.S. 645 (1995).

16. 530 U.S. 211 (2000).

17. 29 U.S.C. § 1002(1)(A) (1994).

18. *See* Patricia C. Kuszler, *Financing Clinical Research and Experimental Therapies: Payment Due, but from Whom?*, 3 DEPAUL J. HEALTH CARE L. 441, 470 n.218 (2000) ("ERISA

Employees and beneficiaries, who complain that an ERISA plan has improperly denied medical treatment, can bring a claim under section 502(a) of ERISA's civil enforcement provisions, which provides that

> [a] civil action may be brought (1) by a participant or beneficiary (A) for the relief provided for in subsection (c) of this section, or (B) to recover benefits due to him under the terms of his plan, to enforce his rights under the terms of the plan, or to clarify his rights to future benefits under the terms of the plan; (2) by the Secretary, or by a participant, beneficiary or fiduciary for appropriate relief under the section 1109 of this title; (3) by the participant, beneficiary, or fiduciary (A) to enjoin any act or practice which violates any provision of this subchapter or the terms of the plan, or (B) to obtain other appropriate equitable relief (i) to redress such violations or (ii) to enforce any provisions of this subchapter or the terms of the plan.[19]

However, because of a narrow Supreme Court interpretation, one who brings claims under section 502(a) can obtain only denied benefits and not compensatory damages.[20] In other words, an employee with an injured right leg, who sues an ERISA plan because the plan denied a treating physician's recommendation that the employee needed three days of hospitalization, cannot obtain compensatory damages if the denial of the hospitalization worsens the employee's condition and causes the employee's death; the only damages under a section 502(a) claim is the monetary value of the denied three days of hospitalization.

Given the absence of an adequate compensatory damage remedy under section 502(a), many employees and beneficiaries have brought state law claims under various common law and statutory theories. However, some courts have held that section 514(a) of ERISA, the infamous preemption clause, preempts many of the state law claims that employees and beneficiaries have filed against ERISA plans and some of the claims that they have filed against HMOs and other managed care organizations. The preemption clause provides that

> [e]xcept as provided in subsection (b) of this section, the provisions of this subchapter and subchapter III of this chapter shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan described in section 1003(a).[21]

The following discussion shows the current status of the Court's and lower-level federal courts' interpretation of the preemption clause.

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plans may contract with an insurer, third party administrator, or most commonly, managed care plan to administer the benefits and process claims, while the employer retains the risk of losses.").

19. 29 U.S.C. § 1132(a) (1988 & Supp. V 1993).

20. *See generally* Mertens v. Hewitt Assocs., 508 U.S. 248 (1993); Mass. Mut. Life Ins. Co. v. Russell, 473 U.S. 134 (1985).

21. 29 U.S.C. § 1144(a) (1994).

II. From a Literal Interpretation of ERISA's Preemption Clause to an Interpretation That Gives Deference to States' Police Power Regulations and ERISA's Underlying Objectives

Elsewhere I have argued that the Supreme Court, when interpreting ERISA's preemption clause, "should establish and consistently apply a presumption against the preemption of state laws of general application that are not specifically designed to regulate ERISA's welfare benefit plans,"[22] and that ERISA's underlying objectives and purposes should govern the application of ERISA's preemption clause.[23] This Article will show that the Supreme Court's decisions in *New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Insurance Co.*,[24] in *California Division of Labor Standards Enforcement v. Dillingham Construction*[25] and in *De Buono v. NYSA-ILA Medical and Clinical Services Fund*[26] have made substantial progress in changing the Court's ERISA preemption analysis. In these cases, the Court indicated that it will give paramount importance to a presumption against the preemption of state laws in areas of traditional state regulation[27] and that it has a preference against the preemption of state laws that do not intrude on either ERISA's general purpose or its preemption clause purpose.[28] One could say that *Travelers*, *Dillingham Construction*, and *De Buono* are the Court's "presumption-objectives trilogy,"[29] and that they evidence a new direction in the Court's analysis of ERISA's preemption clause. These cases, and lower-level federal court cases interpreting *Travelers*, employ an "equitable construction" or "equitable interpretation" approach when analyzing whether ERISA's

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22. Larry J. Pittman, *ERISA's Preemption Clause and the Health Care Industry: An Abdication of Judicial Law-Creating Authority*, 46 Fla. L. Rev. 355, 409 (1994). This suggestion stemmed from the fact that the Supreme Court's interpretation of ERISA's preemption clause has historically vacillated between a literal application of the *Black's Law Dictionary* definition of "relate to" ("a connection with and a reference to") and an objectives-purposes interpretation that imposes preemption only when a state law has an impermissible impact on ERISA's underlying objectives and purposes. *See id.* at 384-412.

23. *See id.* at 401, 410.

24. 514 U.S. 645 (1995).

25. 519 U.S. 316 (1997).

26. 520 U.S. 806 (1997).

27. *See De Buono*, 520 U.S. at 813; *Dillingham Constr.*, 519 U.S. at 331; *Travelers*, 514 U.S. at 654.

28. *Travelers*, 514 U.S. at 655.

29. This label is a short hand indication of the substance of the Court's new approach to ERISA's interpretation. Primarily, the trilogy establishes that in analyzing an ERISA preemption issue, the Court will take a quick look to see if the challenged state law has either a "reference to" or a "connection with" an ERISA plan. If the state law does not meet these tests, the Court will apply the presumption against the preemption of traditional state law regulation and determine whether the state law interferes with ERISA's preemption clause objectives. It appears that ERISA will not preempt the state law if it does not interfere with the preemption clause objectives.

preemption clause preempts state laws and lawsuits.[30] Conceptually, the use of equitable construction means that, instead of relying upon a strict textualist interpretation of ERISA's preemption clause, the Court will give the preemption clause an interpretation that effectuates ERISA's general purposes and its preemption clause purposes.[31]

Arguably, the Court's use of equitable construction in *Travelers* has two implications. First, ERISA's purposes and objectives are to be the predominate factors in determining when ERISA preempts state laws.[32] Second, federal courts are free to use other equitable principles when interpreting ERISA's preemption clause.[33] Therefore, as argued in Part VI, federal courts should draw on their equity jurisprudence, including its principles and maxims, when interpreting ERISA's preemption clause.[34] This argument is based on the notion that a court's interpretation of ERISA's preemption clause falls within the court's equity jurisdiction in part because trust law principles are applicable to an interpretation of ERISA's statutory provisions.[35] Therefore, as a matter of equity, courts should interpret the preemption clause to achieve equitable and fair results.[36] Thus, a major conclusion from this Article is that the Court and lower-level federal courts, when interpreting ERISA's preemption clause, should use the equity maxim that "equity will not suffer a wrong without a remedy."[37] This is a principle that will help courts obtain fairer and more equitable results when interpreting ERISA's preemption clause.

This Article labels the use of courts' equity jurisdiction during an ERISA

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30. Basically, equitable construction or equitable interpretation means that, when interpreting and applying a statute to a particular case before the court, the court will use the purposes and objectives underlying the statute to determine how the statute should be applied to the case before the court, instead of relying on a plain meaning or textualist interpretation of the statute. For a discussion of equitable construction, see generally Raymond B. Marcin, *Epieikeia: Equitable Lawmaking in the Construction of Statutes*, 10 CONN. L. REV. 377 (1978); Robert J. Martineau, *Craft and Technique, Not Canons and Grand Theories: A Neo-Realist View of Statutory Construction*, 62 GEO. WASH. L. REV. 1 (1993).

31. *See Travelers*, 514 U.S. at 655-56.

32. *See id.*

33. Although the Court in *Travelers* did not speak on this issue, the Court's conclusion that ERISA's objectives and purposes are important in the interpretation of ERISA's preemption clause leads to the conclusion that the principle of equity construction should be used, which further leads to the conclusion that equity principles that are designed to achieve a fair and equitable interpretation of the preemption clause should also be used.

34. *See infra* notes 295-325.

35. *See infra* note 294.

36. Although the Court in *Travelers* did not state that ERISA's preemption clause should be interpreted in a manner to achieve equitable and fair results, it is doubtful that the Court would argue that the preemption clause should be interpreted so as to achieve inequitable and unfair results.

37. JOHN NORTON POMEROY, 2 EQUITY JURISPRUDENCE § 423 (Spencer W. Symons ed., Lawyers Coop. Publ'g Co. 1941) (1881).

preemption analysis as "equity preemption," and argues that *Travelers*, *Dillingham Construction*, and *De Buono* have started the Court's journey towards the use of "equity preemption."[38]

A. Equitable Construction and Blue Cross v. Travelers[39]

Blue Cross v. Travelers is the first case in the Court's trilogy. In *Travelers*, the Court held that ERISA's preemption clause did not preempt a New York law mandating that commercial insurers pay surcharges on hospital bills,[40] when Blue Cross/Blue Shield plans did not have to pay the surcharges.[41] Although the surcharges created an incentive for cost conscious ERISA plans to choose the Blue Cross/Blue Shield plans over commercial insurers,[42] the Court held that such an indirect economic influence did not justify preemption under ERISA's preemption clause.[43]

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38. "Equity preemption" is a name developed by this Author to suggest that equity's principles and maxims should be used to control courts' interpretation of ERISA's preemption clause.

39. N.Y. State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co., 514 U.S. 645 (1995).

40. The total effect of the surcharge (including the portion maintained by the hospitals and the portion given to the state) meant that commercial insurers were charged twenty-four percent more per affected hospital bill (the DRG rate plus a twenty-four percent surcharge) than Blue Cross and Blue Shield service plans that had to pay only the established DRG rate. *See id.* at 650.

41. *See id.* at 667-68.

42. *See id.* at 659. Presumably, if an ERISA plan chooses Blue Cross it would pay a smaller premium because Blue Cross did not have to increase their premiums or fees to offset the loss of profits caused by having to pay the twenty-four percent surcharge. The Second Circuit held that the surcharge was a "'purposeful interference with the choices that ERISA plans make for health care coverage . . . [and was] sufficient to constitute [a] "connection with" ERISA plans' triggering preemption." *Id.* at 654 (quoting *Travelers*, 14 F.3d 708, 719 (2d Cir. 1994)). The gist of the Second Circuit's opinion was that "'the three surcharges 'relate to' ERISA because they impose a significant economic burden on commercial insurers and HMOs' and therefore 'have an impermissible impact on ERISA plan structure and administration.'" *Id.* (quoting *Travelers*, 14 F.3d at 721). The Supreme Court did not find such reasoning to be persuasive. *See id.*

43. *See id.* at 659. The indirect economic influence at issue in *Travelers* occurred because the New York law imposed the surcharge on only the hospital bills that commercial insurers paid on behalf of those receiving benefits under ERISA plans and not on the bills of those ERISA beneficiaries whose bills were paid by Blue Cross and Blue Shield. *See id.* at 654. The alleged impermissible effect would be experienced when the surcharges would drive up the cost of obtaining insurance coverage and health benefits from commercial insurance carriers and HMOs in that they, being the only one required to pay the surcharges, would pass the cost of the surcharges to ERISA plans, thereby increasing the expenses of the ERISA plans that wanted to offer coverage through commercial insurers and HMOs. As such, the surcharges would indirectly influence the sources of benefits that the ERISA plans would offer to their beneficiaries, which in effect would be an indirect influence on the structure and administration of ERISA plans. *See id.* at 653-54.

To get a sense of how the Court arrived at its decision that ERISA did not preempt New York's surcharge law, the Court's use of equitable construction is instructive. The Court had to use equitable construction because ERISA's preemption clause did not specifically refer to or cover New York's surcharges, unless one applies a broad, textualist interpretation of "relate to."[44] However, instead of relying on a textualist interpretation, the Court employed a three-step equitable construction analysis: (1) the Court recognized a "start[l]ing presumption" against ERISA's preemption of state laws that are a part of a state's "historical police power" regulation unless there is a congressional intent that preemption should occur;[45] (2) the Court examined the language of ERISA's preemption clause for a "clear and manifest purpose" to rebut the "startling presumption";[46] and (3) because the language did not clearly show a congressional intent to preempt the state law, the Court examined "the structure and purpose" of ERISA to see whether they showed a congressional intent to preempt the state law.[47] The Court's use of the three-step analysis is informative.

First, having recognized the "startling presumption" against the preemption of state law regulation in areas of traditional state concern,[48] the Court gave its strongest criticism of ERISA's preemption clause's language. The Court recognized the dangers of a too expansive interpretation of "relate to,"[49] emphasizing its indeterminancy and that a literal, plain meaning interpretation of the phrase would mean that "for all practical purposes pre-emption would never run its course, for '[r]eally, universally, relations stop nowhere.'"[50]

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44. However, the Court was critical of the broad scope of "relate to," asserting that a broad interpretation would mean that almost any state law affecting the cost of an ERISA plan would have some relation to the plan. *See id.* at 655.

45. *Id.* at 654-55. First, the Court restricted the scope of federal preemption by reaffirming its commitment to "the start[l]ing presumption that Congress does not intend to supplant state law," especially when the state law is an exercise of a state's "historical police powers" regulation. *Id.* at 655. This presumption applies to all three types of federal preemption of state laws. *See id.* at 654. The three types are "express preemption," where a federal law expressly indicates a preemption of state law; preemption by implication where, although not expressly preempted, a state law is implicitly preempted by either a federal law's language or its policies or purposes; and conflict preemption where there is "a conflict between federal and state law." *Id.* at 654 (citing Pac. Gas & Elec. Co. v. State Energy Res. Conservation & Dev. Comm'n, 461 U.S. 190, 203-04 (1983)).

The "startling presumption" means that the Court will not find preemption unless Congress had a "clear and manifest purpose" to preempt the state law. *Id.* at 655 (quoting Rice v. Sante Fe Elevator Corp., 331 U.S. 218, 230 (1947)). If Congress's intent is not clearly expressed in a federal statute's language, the Court will examine "the structure and purpose of" the law to ascertain whether congressional intent is in favor of preemption. *Id.*

46. *Id.* at 665-66.

47. *Id.* at 655.

48. *Id.* at 654.

49. *Id.* at 656.

50. *Id.* at 655 (quoting H. JAMES, RODERICK HUDSON, at xli (New York ed., World's Classics 1980)). The Court stated:

Despite the indeterminancy of "relate to," the Court took a quick look at the definition of the phrase to ascertain whether it preempted New York's surcharges.[51] First, the Court held that the "reference to" prong of "relate to" was not applicable because the surcharges were imposed on patients' medical bills regardless of whether the medical services were provided through commercial insurers, HMOs, or ERISA plans.[52] Second, the Court stated that the "connection with" prong of "relate to" was just as indeterminate and unhelpful as "relate to" itself given its "infinite connections."[53] Therefore, eschewing an "uncritical literalism" in interpreting "relate to,"[54] the Court went to the third step in its analysis, stating that "[w]e simply must go beyond the unhelpful text and the frustrating difficulty of defining [ERISA's] key term, and look instead to the objectives of [] ERISA" to control the scope of ERISA's preemption of state laws.[55] The relevant objective was the preemption clause objective of "avoid[ing] a multiplicity of regulation in order to permit the nationally uniform administration of employee benefit plans."[56] That objective is primarily

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> The governing text of ERISA is clearly expansive. Section 514(a) marks for pre-emption "all state laws insofar as they . . . relate to any employee benefit plan" covered by ERISA, and one might be excused for wondering, at first blush, whether the words of limitation ("insofar as they . . . relate") do much limiting. If "relate to" were taken to extend to the furthest stretch of its indeterminacy, then for all practical purposes pre-emption would never run its course, for "really, universally, relations stop nowhere,". . . . But that, of course, would be to read Congress's words of limitation as mere sham, and to read the presumption against pre-emption out of the law whenever Congress speaks to the matter with generality. That said, we have to recognize that our prior attempt to construe the phrase "relate to" does not give us much help drawing the line here.

Id. at 655 (internal citation omitted).

51. *See id.* at 655-56.

52. *See id.* at 656.

53. *Id.*

54. *Id.*

55. *Id.*

56. *Id.* at 657. Implicit in the preemption clause objective is the notion that Congress intended "to minimize the administrative and financial burden of complying with conflicting directives among States or between States and the Federal Government . . . , [and to prevent] the potential for conflict in substantive law . . . requiring the tailoring of plans and employer conduct to the peculiarities of the law of each jurisdiction." *Id.* at 656-67 (quoting Ingersoll-Rand Co. v. McClendon, 498 U.S. 133, 138 (1990)).

In referencing the congressional comments by Senator Williams, the Court opened up the possibility that field preemption of state laws might be one means of dealing with ERISA's preemption issues:

> Senator Williams made the same point, that "with the narrow exceptions specified in the bill, the substantive and enforcement provisions . . . are intended to preempt the field for Federal regulations, thus eliminating the threat of conflicting or inconsistent State and local regulation of employee benefit plans."

implicated when a state law changes either the structure or the administration of an employee benefit plan.[57] In *Travelers*, the Court did not find preemption because the surcharge law did not alter either the structure or the administration of ERISA benefits, even though it would have given ERISA plans an "indirect economic influence" to choose cheaper Blue Cross health plans over commercial insurers' and HMOs' plans.[58] However, that indirect economic influence was insufficient to warrant preemption.[59] The Court reasoned that a finding of preemption due to the surcharge's indirect economic influence would mean that ERISA would preempt a host of other state law regulations with indirect economic influences, including state quality control standards that also increase ERISA plans' cost of providing welfare benefits.[60]

Id. at 657 (citation omitted). Justice Scalia subsequently opined that field preemption would be the appropriate way of resolving ERISA preemption issues. *See* Cal. Div. of Labor Standards Enforcement v. Dillingham Constr., Inc., 519 U.S. 316, 334 (1997) (Scalia, J, concurring).

57. *See Travelers*, 514 U.S. at 657-58. The Court relied on three of its prior preemption cases. First, the Court discussed *Shaw v. Delta Air Lines, Inc.*, 463 U.S. 85 (1983). The case involved preemption of a New York "Human Rights Law, which "prohibit[ed] employers from structuring their employee benefit plans in a manner that discriminate[d] on the basis of pregnancy, and the [New York] Disability Benefits Law, which require[d] employers to pay employees specific benefits." *Id.* at 97. The laws related to ERISA plans because they would have prevented the plans from structuring and administering their benefits in a uniform manner throughout the United States. *See id.* Further reference was made to *FMC Corp. v. Holliday*, 498 U.S. 52 (1990), where preemption was found because the Pennsylvania antisubrogation law would have prevented ERISA plans from obtaining subrogation of beneficiaries' monetary recoveries from third-parties, thereby mandating the structure of an ERISA plan's administration of its benefits obligations. Finally, the Court cited *Alessi* v. *Raybestos-Manhattan, Inc.*, 451 U.S. 504 (1981), regarding preemption of a New Jersey state law that would have prevented ERISA plans from "setting workers' compensation payments off against employees' retirement benefits or pensions, because doing so would prevent plans from using a method of calculating benefits permitted by federal law. *Travelers*, 514 U.S. at 658. The Court concluded: "In each of these cases, ERISA pre-empted state laws that mandated employee benefit structures or their administration. Elsewhere, we have held that state laws providing alternative enforcement mechanisms also relate to ERISA plans, triggering pre-emption." *Id.* (citing *Ingersoll-Rand*, 448 U.S. at 133).

58. *Id.* at 659-60. Regarding the impact of the surcharges on ERISA plans' selection of health benefit providers, the Court stated: "It is an influence that can affect a plan's shopping decisions, but it does not affect the fact that any plan will shop for the best deal it can get, surcharges or no surcharges." *Id.* at 660.

59. The Second Circuit is in compliance with *Travelers* to the extent that in *Connecticut Hospital Ass'n v. Weltman*, 66 F.3d 413 (2nd Cir. 1995), the court held that ERISA did not preempt a Connecticut state law surcharge on the hospital bills of private patients, which the State used to pay for "uncompensated care." *Id.* at 414. As was the case in *Travelers*, the court, in part, held that the state law's indirect economic effect (to the extent that the surcharge was imposed on patients and not on a self-insured ERISA plan) did not either "force an ERISA plan to adopt a certain scheme of substantive coverage or to effectively restrict its choice of insurers." *Id.* at 415.

60. *See Travelers*, 514 U.S. at 660-61. The Court asserted at least two other reasons, each

B. California Division of Labor Standards Enforcement v. Dillingham Construction, Inc.[61]

Dillingham Construction is the second case in the Court's trilogy. In that case, certain ERISA plans, including Dillingham Construction, raised an ERISA preemption challenge against California's prevailing wage law, which required that contractors on public work projects pay their workers the location's prevailing wages unless the workers were participating in an approved apprenticeship program.[62] Writing for the Court, Justice Thomas continued the

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bearing on ERISA's objectives and purposes why ERISA did not preempt the surcharges. First, rate differentials in medical cost, such as New York's surcharges, existed at the time of ERISA's enactment, an indication that Congress did not intend that ERISA would preempt such cost differentials. The Court stated:

> There is, indeed, nothing remarkable about surcharges on hospital bills, or their effects on overall cost to the plans and the relative attractiveness of certain insurers. Rate variations among hospital providers are accepted examples of cost variation, since hospitals have traditionally "attempted to compensate for their financial shortfalls by adjusting their price . . . schedules for patients with commercial health insurance." Charge differentials for commercial insurers, even prior to state regulation, "varied dramatically across regions, ranging from [thirteen] to [thirty-six] percent," presumably reflecting the geographically disparate burdens of providing for the uninsured.
>
> If the common character of rate differentials even in the absence of state action renders it unlikely that ERISA pre-emption was meant to bar such indirect economic influences under state law, the existence of other common state action with indirect economic effects on a plan's costs leaves the intent to pre-empt even less likely. Quality standards, for example, set by the State in one subject area of hospital services but not another would affect the relative cost of providing those services over others and, so, of providing different packages of health insurance benefits. Even basic regulation of employment conditions will invariably affect the cost and price of services.

Id. at 660 (internal citations omitted). Similarly, the Court asserted that Congress' enactment of a federal law, approximately one month after ERISA's enactment, that provided federal funding for state agencies engaged in a similar type of health care rate setting as New York's surcharges, is evidence that Congress did not intend to preempt the surcharges. *See id.* at 666-67.

61. 519 U.S. 316 (1997).

62. *See id.* at 319-21. In *Dillingham Construction*, the general contractor for a Sonoma County detention facility subcontracted the electronic installation work to respondent Sound Systems Media, which in compliance with its collective bargaining agreement with a union, affiliated itself with an apprenticeship program, Communications Systems Joint Apprenticeship Training Committee (Communications Systems); however, the latter failed to obtain approval of its program from the relevant California apprenticeship approval agency. *See id.* at 321. Communications Systems was an ERISA plan under 29 U.S.C. § 1002 (1), which, in part, defines ERISA's welfare benefit plan as an "apprenticeship or other training programs."

Court's criticism of ERISA's preemption clause's "unhelpful text."[63] As in *Travelers*, the Court rejected a strict application of the two analytical prongs of "relate to" (a "reference to" and a "connection with") as "offer[ing] scant utility" in determining the scope of ERISA's preemption.[64] In lieu of a texualist interpretation of the preemption clause, the *Dillingham Construction* Court, as in *Travelers*, looked to ERISA's objectives and followed a presumption against the preemption of states' traditional police power regulations.[65]

However, even with its criticism of the preemption clause's "unhelpful text," the Court initially employed a texualist evaluation of the California prevailing wage law to ascertain whether it made a "reference to" the ERISA plans. There was no "reference to" because the wage law was applicable to non-ERISA apprenticeship programs and it did not explicitly mention ERISA plans.[66] Similarly, there was no "connection with" an ERISA plan.[67] First, the prevailing wage law, like *Travelers*' surcharges, "d[id] not bind ERISA plans to anything" since a contractor on a California public works project "need not hire [workers] from an approved [apprenticeship] program," although ERISA plans had an indirect economic incentive to do so to pay lower apprenticeship wages instead of higher prevailing wages.[68] Second, given that the state wage law did not mandate ERISA plan structure or plan choices when hiring workers, the Court held that ERISA did not preempt the state law.[69]

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63. *Dillingham Constr.*, 519 U.S. at 328

64. *Id.* at 325.

65. *See id.*

66. *See id.* at 325-26. Had the California law been applicable only to ERISA plans (apprenticeship plans funded through a separate fund, instead of through an employer's general assets), the Court implied that the state law would be preempted under the "reference to prong" of "relate to." *Id.* However, the wage law "function[ed] irrespective of . . . the existence of an ERISA plan." *Id.* at 328.

67. "Connection with" would have existed if the prevailing wage law had bound "plan administrators to any particular choice and thus function[ed] as a regulation of an ERISA plan itself." *Id.* at 329. Moreover, "connection with" would have been satisfied if the law had "preclude[d] uniform administrative practice or the provision of a uniform interstate benefit package if a plan wished[d] to provide one," or "mandated employee benefit structures or their administration." *Id.* at 328-29. Mandating benefits or changing the structure of an ERISA plan has resulted in the Court finding preemption of state laws. *Id.* at 328 (citing Shaw v. Delta Air Lines, Inc, 463 U.S. 85 (1983); Alessi v. Raybestos-Manhattan, Inc., 451 U.S. 504 (1981)).

68. *Id.* at 332.

69. *See id.* at 333. The Court stated:

> The prevailing wage statute alters the incentives, but does not dictate the choices, facing ERISA plans. In this regard, it is "no different from myriad state laws in areas traditionally subject to local regulation, which Congress could not possibly have intended to eliminate." We could not hold pre-empted a state law in an area of traditional state regulation based on so tenuous a relation without doing grave violence to our presumption that Congress intended nothing of the sort. We thus conclude that California's prevailing wage laws and apprenticeship standards do not have a

In one sense, the Court's analysis in *Dillingham Construction* was an application of the "startling presumption" against the preemption of state laws. Like the surcharges at issue in *Travelers*, the prevailing wage laws in *Dillingham Construction* have traditionally been a province of states' police power regulation.[70] Although *Travelers* did not limit ERISA's preemption to areas specifically regulated by ERISA,[71] *Dillingham Construction* recognized that preempting state law in areas that ERISA does not regulate would be "unsettling."[72]

C. De Buono v. NYSA-ILA Medical and Clinical Services Fund[73]

De Buono is the third case in the Court's trilogy. In *De Buono,* trustees administering a self-insured, employee benefit plan, which owned and operated three medical care facilities, filed suit against New York challenging a state law that assessed a 0.6 percent tax on the gross receipts of health care facilities.[74] The trustees sought ERISA preemption, contending that the state law "related to" the plan because it increased the plan's operating expenses by forcing it to pay more taxes on plan-owned medical facilities.[75] In resolving the preemption issue, the Court, as in *Travelers* and in *Dillingham Construction*, relied upon ERISA's objectives and the "startling presumption" against the preemption of state law in areas of traditional state regulation.[76]

As the hospital revenue taxes were a part of states' traditional regulations, and since the ERISA plan trustee failed to overcome the presumption against the preemption of state police power regulation, the Court held that ERISA did not

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"connection with," and therefore do not "relate to," ERISA plans.

Id. at 334.

70. *See id.* at 330.

71. *See id.* Those areas are "reporting, disclosure, fiduciary responsibility, and the like." *Id.* (quoting N.Y. State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co., 514 U.S. 645, 661 (1995)).

72. *Id.* The full parameters or limits of the Court's "unsettling" concerns might not provide any indication of the manner in which the Court will resolve disputes in the future, given *Travelers*'s commitment to following prior precedents finding preemption of state laws in areas that are not directly regulated by ERISA. *See Travelers*, 514 U.S. at 663-64.

73. 520 U.S. 806 (1997).

74. *See id.* at 810.

75. *See id.*

76. *Id.* at 813 (citing *Travelers*, 514 U.S. at 655; *Dillingham Constr.*, 519 U.S. at 323-24). Several cases have cited *De Buono*'s reference to the presumption against the preemption of health care regulations. Philip Morris, Inc. v. Harshbarger, 122 F.3d 58, 68 (1997) ("[T]here exists an assumption that federal law does not supersede a state's historic police powers unless that [is] the clear and manifest purpose of Congress."). This presumption is applicable to health and safety regulations. *See id.* (citing Hillsborough County v. Automated Med. Labs, 471 U.S. 707, 715 (1985) (noting the "presumption that state or local regulation of matters related to health and safety is not invalidated under the Supremacy clause")).

preempt the state tax law.[77] Although the revenue law "impos[ed] some burdens on the administration of ERISA plans,"[78] the Court reasoned that those burdens were the same ones that would have been incurred if the ERISA plan had not owned the medical facilities, but instead was forced to suffer the detriment of the tax revenue when other owners of the facilities increased their fees.[79] In effect, *De Bono* is like *Travelers* to the extent that it reaffirmed that a potential reduction of an ERISA plan's funds, through either a direct or indirect influence, respectively, alone is not sufficient to warrant preemption, especially in areas traditionally regulated by states.

III. Continuing Indeterminacy of ERISA Preemption

When taken together, the Court's recent decisions in the "presumption-objectives trilogy" do not definitively set the parameters of ERISA preemption. However, these cases disclose certain principles that are important to an ERISA preemption analysis. One implication from *Travelers* is that, although abandoning a literal, textualist application of "relate to,"[80] the Court still takes

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77. *See De Buono*, 520 U.S. at 814. The Court reached its decision primarily by distinguishing the revenue law from some of those state laws that ERISA has preempted. *See id.* The revenue laws did not

> forbid[] a method of calculating pension benefits that federal law permits, or require[] employers to provide certain benefits. Nor [was] it a case in which the existence of a pension plan is a critical element of a state-law cause of action, or one in which the state statute contains provisions that expressly refer to ERISA or ERISA plans.

Id. (citation omitted).

78. *Id.* at 815.

79. *See id.* at 815-16. The Court stated:

> HFA is a tax on hospitals. Most hospitals are not owned or operated by ERISA funds. This particular ERISA fund has arranged to provide medical benefits for its plan beneficiaries by running hospitals directly, rather than by purchasing the same services at independently run hospitals. If the Fund had made the other choice, and had purchased health care services from a hospital, that facility would have passed the expense of the HFA onto the Fund and its plan beneficiaries through the rates it set for the services provided. The Fund would then have had to decide whether to cover a more limited range of services for its beneficiaries, or perhaps to charge plan members higher rates. Although the tax in such a circumstance would be "indirect," its impact on the Fund's decisions would be in all relevant respects identical to the "direct" impact felt here. Thus, the supposed difference between direct and indirect impact—upon which the Court of Appeals relied in distinguishing this case from *Travelers*—cannot withstand scrutiny. Any state tax, or other law, that increases the cost of providing benefits to covered employees will have some effect on the administration of ERISA plans, but that simply cannot mean that every state law with such an effect is pre-empted by the federal statute.

Id.

80. *See De Buono*, 520 U.S. at 813; *Dillingham Constr.*, 519 U.S. at 325; *Travelers*, 514 U.S.

a look at the relationship between a disputed state law and an ERISA benefit plan to see whether the law has a "reference to" or a "connection with" the plan.[81] There will be no "reference to" if the state law is applicable to all health plans and not just to ERISA plans, especially if the language of the state law does not specifically refer to or mention ERISA plans.[82] There will be no "connection with" unless the state law (1) binds ERISA plan administrators' choices and thereby functions as a regulation of the plan; (2) prevents an ERISA plan from having uniform administrative practices or from offering an interstate uniform benefit package; or (3) "mandate[s] employee benefit structures or their administration."[83]

If neither a "reference to" nor a "connection with" is found, the Court will ascertain whether the state law interferes with ERISA's preemption clause objectives.[84] The primary objectives appear to be: (1) "ensur[ing] that plans and plan sponsors would be subject to a uniform body of benefits law," (2) "minimiz[ing] the administrative and financial burden of complying with conflicting directives among States or between States and the Federal Government," and (3) "prevent[ing] the potential for conflict in substantive law . . . requiring the tailoring of plans and employer conduct to the peculiarities of the law of each jurisdiction."[85] In sum, one can reasonably conclude that ERISA will not preempt a state law that either does not make a specific reference to an ERISA plan, does not have a "connection with" an ERISA plan, or does not interfere with ERISA's preemption clause objectives.

A second implication from the "presumption-objectives trilogy" involves the Court's recognition of the "startling presumption" against the preemption of state

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at 656.

81. *See Dillingham Constr.*, 519 U.S. at 325-27.

82. *See Travelers*, 514 U.S. at 656.

83. *Dillingham Constr.*, 519 U.S. 327-29.

84. *See Travelers*, 514 U.S. at 656.

85. *Id.* at 656-57. The trilogy does not delineate the degree to which ERISA's general purpose will be considered when resolving preemption issues. This general purpose is the protection of beneficiaries from "the mismanagement of funds accumulated to finance employee benefits and the failure to pay employees benefits from accumulated funds." *Dillingham Constr.*, 519 U.S. at 327-28. The Court considered these purposes in *Dillingham Construction* in deciding whether the California prevailing wage law had a "reference to" ERISA plans to the extent that it was applicable only to ERISA plans. *Id.* As the law was also applicable to non-ERISA plans, the Court did not find a "reference to" an ERISA plan. *Id.*

Somehow, the Court must reconcile the preemption clause purposes with ERISA's general purpose to establish the circumstances under which the general purpose will trump the preemption clause purposes. *See* Pittman, *supra* note 22, at 357-61 (discussing ERISA's primary purposes). Presently, the Court's cases have primarily involved an analysis of state laws' impact on the preemption clause purposes. *See Travelers*, 514 U.S. at 656-57.

At bottom, the biggest impact of the "presumption-objectives trilogy" is the cases' indication that the Court is grappling with approaches to limit the scope of ERISA preemption. The full ramification of the "presumption-objectives trilogy" remains open.

laws unless Congress has expressed a clear and manifest intent that preemption should occur.[86] The strength and boundaries of this presumption are not clear.

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86. *See Travelers*, 514 U.S. at 654. An analysis of the history of this "startling presumption" is important in ascertaining whether the presumption has a congressional source or whether it is a rule of statutory construction that the Court uses as an aid when interpreting a statute. If the latter is true, then the "startling presumption" is nothing but a principle of equitable construction that the Court uses to fill gaps between the language of a federal statute and a specific state law when the Court is considering whether the federal law preempts the state law.

Apparently, the Court's use of the "startling presumption" is simply a conclusive statement that the Court uses when considering whether a federal law preempts a state law. The Court generally cites to an earlier case that has stated the same proposition without much analysis regarding the legal source of the presumption. Therefore, it might be useful to trace *Travelers*' reference to the "startling presumption" back to the earlier cases that stated the presumption. For example, without much analysis of the legal source of the presumption, *Travelers* cites *Maryland v. Louisiana*, 451 U.S. 725, 746 (1981), for the proposition that there is a "startling presumption against the preemption of state law." *Travelers*, 514 U.S. at 654-55. *Maryland* cites *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947), for the proposition that "[c]onsideration under the Supremacy Clause starts with the basic assumption that Congress did not intend to displace state law." *Maryland*, 451 U.S. at 746. *Rice* cites *Napier v. Atlantic Coast Line Railroad Co.*, 272 U.S. 605, 611 (1926), and *Allen-Bradley Local v. Wisconsin Employment Relations Board*, 315 U.S. 740, 749 (1942), that "we start with the assumption that the historic police powers of the States were not to be susperseded by the Federal Act unless that was the clear and manifest purpose of Congress." *Rice*, 331 U.S. at 230. *Napier* cites *Reid v. Colorado*, 187 U.S. 137, 148 (1902), and *Savage v. Jones*, 225 U.S. 501, 533 (1912), for the proposition that "[t]he intention of Congress to exclude states from exerting their police power must be clearly manifested." *Napier*, 272 U.S. at 611. In *Reid* the Court stated:

> It should never be held that Congress intends to supersede, or by its legislation suspend, the exercise of the police powers of the states, even when it may do so, unless its purpose to effect that result is clearly manifested. This court has said—and the principle has been often reaffirmed—that 'in the application of this principle of supremacy of an act of Congress in a case where the state law is but the exercise of a reserved power, the repugnance or conflict should be direct and positive, so that the two acts could not be reconciled or consistently stand together.

Reid, 187 U.S. at 148.

In *Savage*, the Court stated:

> This question must, of course, be determined with reference to the settled rule that a statute enacted in execution of a reserved power of the state is not to be regarded as inconsistent with an act of Congress passed in the execution of a clear power under the Constitution, unless the repugnance or conflict is so direct and positive that the two acts cannot be reconciled or stand together.

Savage, 225 U.S. at 535 (1912).

Therefore, a review of relevant Court opinions shows that the "startling presumption" is but a Court imposed rule of statutory construction without any congressional sources. Furthermore, the scope and the meaning of this presumption have changed. In latter cases such as *Travelers*, and some of its Supreme Court progeny, the Court stated the presumption as "the startling presumption

However, *Dillingham Construction* seems to restrict the presumption against preemption by either establishing or reaffirming that, even in areas of traditional police power regulation, preemption is proper if the affected state law has either a "reference to" or a "connection with" an ERISA plan, or if the state law interferes with ERISA's preemption clause purposes.[87]

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that Congress does not intend to supplant state law" and "the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress." *Travelers*, 514 U.S. at 645, 655 (citing Hillsborough County v. Automated Med. Labs., Inc., 471 U.S. 707, 719 (1985)).

On the other hand, one can argue that the earlier cases stated that the presumption required a "direct and positive" conflict between a state and a federal law that regulated in the same field before the federal law would preempt the state law. *Reid*, 187 U.S. at 148. This raises two points. First, the manner in which the Court states the presumption might determine whether a particular state law is preempted. Second, since the presumption is a Court-made rule of statutory construction, the Court can use the presumption to engage in an equitable construction of a federal law that in fact could amount to judicial lawmaking to fill a gap between the language of a federal statute and its preemptive effects on a particular state law. In other words, the Court can use the "startling presumption" to narrow the preemptive effects of ERISA's broad preemption clause. That is, if the meaning of the phrase "relate to" is so broad that ERISA's preemption would never run its course, as Justice Souter stated in *Travelers*, then why did the Court not find that ERISA preempted New York's surcharges? If "relate to" and its "connection with" prong have infinite relations and connections, then the scope of these phrases is broad enough to encompass New York's surcharges and therefore lead to a preemption of the surcharges. However, through an equitable construction of ERISA's preemption clause, and "relate to," the Court effectively engaged in judicial lawmaking and found that ERISA's preemption clause should not be interpreted as broad as it could be. The Court stated that to give "relate to" its broadest interpretation "would be to read Congress's words of limitation as mere sham, and to read the presumption against preemption out of the law whenever Congress speaks to the matter with generality." *Travelers*, 514 U.S. at 655. One could argue that it seems ironic that to protect its own Court-created presumption, the Court would intimate that it would narrowly interpret ERISA's preemption clause to save the presumption against the preemption of state laws. One could also argue that when the Court does not interpret a federal law's preemption clause as broadly as possible, the Court is engaging in judicial lawmaking, despite the fact that the Court might couch its lawmaking in the guise of enforcing congressional intent through the ascertainment of the federal statute's object and purpose. However, it seems reasonable to conclude that Congress envisioned the use of judicial lawmaking to establish the parameters of ERISA's preemption. *See infra* note 88 and accompanying text. For a general statement of how the Second Circuit performs an analysis by using the presumption against the preemption of state laws, see *infra* note 285. *See generally* Marcin, *supra* note 30.

87. *See Dillingham Constr.*, 519 U.S. at 324-25. Importantly, even in light of the trilogy, it appears that the "startling presumption" against the preemption of state police power regulations will save a state law from preemption only when there is no conflict between the state law and ERISA's preemption clause purposes. *See id.* at 330. The Court stated:

> That the States traditionally regulated these areas would not alone immunize their efforts; ERISA certainly contemplated the preemption of substantial areas of traditional state regulation. The wages to be paid on public works projects and the substantive

> standards to be applied to apprenticeship training programs are, however, quite remote from the areas with which ERISA is expressly concerned—"reporting, disclosure, fiduciary responsibility, and the like." . . . A reading of § 514 (a) resulting in the pre-emption of traditionally state-regulated substantive law in those areas where ERISA has nothing to say would be "unsettling."

Id. (internal citations omitted).

That state regulations, even in traditional police power areas, may be preempted in the ERISA arena if such laws "interfere[] or [are] contrary to federal law" is consistent with general federal preemption doctrine. Philip Morris, Inc. v. Harshbarger, 122 F.3d 58, 67 (1st Cir. 1997). However, like *Travelers*, *Dillingham Construction* leaves several issues unresolved. First, the scope of the "unsettling" nature of preempting state laws in areas that ERISA does not specifically regulate needs clarification. At best, the Court's use of the word "unsettling" should lead to more scrutiny of preemption arguments that affect state laws in areas where there is no specific ERISA regulation. However, it is doubtful that the Court will reverse prior cases that have found preemption in such areas. Second, although critical of ERISA's "unhelpful text," the Court still attempts to apply a "connection with" analysis which raises doubts whether *Travelers* and *Dillingham Construction* really alters or improve the Court's prior attempts to interpret ERISA's preemption clause. Third, the Court implied that the preemption of "medical-care quality standards . . . that increase[] costs of providing certain benefits" would stretch ERISA preemption to an unreasonable limit. *Dillingham Constr.*, 519 U.S. at 329.

When considered in conjunction with the "unsettling" prospect of preempting state law in non-ERISA regulated areas, the presumption against the preemption of traditional state police power regulation, and the non-dispositive effect of an indirect economic influence on ERISA plan choices, could lead to a conclusion that one effect of the "medical-care quality standards" exception to ERISA preemption might be the non-preemption of state statutes and common law doctrines regulating the practice of medicine through medical malpractice lawsuits. Although the Court, on a case-by-case basis, will determine the impact of the presumption on ERISA preemption, the Court should establish and recognize, as a general proposition, that in close cases the use of the presumption against preemption should mean that ERISA will not preempt state laws unless the laws have a significant impact on ERISA plans.

One potential roadblock to the non-preemption of state malpractice lawsuits is the *Pilot Life* Court's statements that ERISA's six civil enforcement provisions are meant to be the only remedy for a claim alleging an improper processing of a claim for benefits. Pilot Life Ins. Co. v. Dedeaux, 481 U.S. 41, 52-57 (1987). *See* text accompanying *infra* notes 326-78.

Another hindrance might be the Court's inability to recognize that a claim for medical malpractice during an ERISA plan's utilization review process, that is premised on an ERISA plan's or managed care organization's violation of an independent state law obligation, is different in kind from a claim merely seeking denied benefits because of an alleged improper processing of a claim for benefits.

In addition to the above-discussed issues, Justice Scalia's concurring opinion, joined by Justice Ginsberg, emphasized that the Court's opinion in *Dillingham Construction* would not bring clarity to ERISA preemption issues, primarily because "it does obeisance to all our prior cases, instead of acknowledging that the criteria set forth in some of them have in effect been abandoned." *Dillingham Constr.*, 519 U.S. at 335 (Scalia, J., concurring). Their approach would be to deem "relate to" as being "irrelevant" as a guide to ERISA preemption, except that its only significance

A third implication from *Travelers* and its progeny is the Court's reaffirmation of the "too tenuous, remote, or peripheral" exception to ERISA's preemption.[88] Although one interpretation of the "presumption-objectives trilogy" is that the Court has adopted, or is moving toward the adoption of, a new

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would be to identify the regulation of "employee benefits" as the field to be considered in applying ordinary federal field preemption. *See id.* Interestingly, Justice Scalia did not cite any legislative history to support his conclusion regarding Congress' intent to employ field preemption. *See id.* Similarly, Justice Scalia did not specifically identify those "criteria" employed in prior cases that have been abandoned. *See id.*

However, support for field preemption might be found in Senator Williams' legislative history statements, "with the narrow exceptions specified in the bill, the substantive and enforcement provisions . . . are intended to preempt the *field* for Federal regulation, thus eliminating the threat of conflicting or inconsistent State and local regulation of employee benefit plans." *Travelers*, 514 U.S. at 657 (quoting 120 CONG. REC. 29933 (1974) (statement of Sen. Williams) (emphasis added)). Although the Court in *Travelers* cited Senator Williams' above-referenced statement, it did not adopt field preemption as the proper method for ERISA's preemption; rather, it chose to disregard ERISA preemption clause's "unhelpful text" and "look instead to the objectives of the ERISA statute as a guide to the scope of the state law that Congress understood would survive" preemption, namely the objective of ERISA preemption clause. *Id.* at 656.

88. The Court stated that a broad interpretation of the preemption clause to preempt "all state laws affecting costs and charges" of an ERISA plan "could not be squared with our prior pronouncement that '[p]re-emption does not occur . . . if the state law has only a tenuous, remote, or peripheral connection with covered plans, as is the case with many laws of general applicability.'" *Id.* at 661 (citing District of Columbia v. Greater Wash. Bd. of Trade, 506 U.S. 125, 130 n.1 (1992)).

The "too tenuous, remote, or peripheral" exception was first cited in *Shaw v. Delta Air Lines, Inc.*, 463 U.S. 85, 100 n.21 (1983). For that proposition, the Court cited *AT&T v. Merry*, 592 F.2d 118, 121 (2d Cir. 1979), which allowed a "state garnishment of a spouse's pension income to enforce alimony and support orders." *Shaw*, 463 U.S. at 100 n.21. The equitable construction implication of the "too tenuous, remote, or peripheral" exception is that, to the extent that the exception prevents a broad application of ERISA's preemption clause by exempting from preemption those state laws having only a tenuous or insubstantial impact on ERISA plans, the Court's use of the exception is judicial lawmaking. It is judicial lawmaking because the Court has decided that it will not enforce the broad scope of ERISA's preemption clause when a state law has a "tenuous, remote, or peripheral" impact on an ERISA plan. If Congress really did, through the use of "relate to," intend that ERISA should preempt any state law that has a "connection with or a reference to" an ERISA plan, then by restricting the broadest application of these phrases, the Court, through judicial lawmaking, is disregarding congressional intent. However, Congress probably had no real idea or knowledge regarding the specific scope of "relate to." Rather, it seems logical that Congress intended that federal courts, through judicial lawmaking during a case-by-case interpretation of ERISA's preemption clause, would establish the legal parameters of "relate to." Therefore, courts' use of the "too tenuous, remote or peripheral" exception, and the presumption against the preemption of state laws in traditional areas of state regulation, is a legitimate interpretative devise to fill gaps between ERISA's statutory language and its application to specific state laws and lawsuits. *See generally* Pittman, *supra* note 22.

method of ERISA preemption analysis, another interpretation might conclude that these cases are a second step in the Court's effort to establish the scope of the "too tenuous, remote, or peripheral" exception announced in *Shaw v. Delta Air Lines*.[89] Essentially, the Court in the trilogy concluded that the state laws' impact on the ERISA plans' financial well-being was too peripheral.[90] In doing so, the Court rejected the "trust fund doctrine" and a reduction in welfare benefit plans' funds as justifications for ERISA's preemption.[91] Regardless of the indefinite scope of the "too tenuous, remote, or peripheral" exception to ERISA preemption, *Travelers* establishes that state laws and lawsuits with only an indirect economic impact on ERISA plans fall within the "too tenuous, remote or peripheral" exception; therefore, ERISA does not preempt such laws and lawsuits.

Clearly, the "too tenuous, remote, or peripheral" exception is a Court-made exception to ERISA preemption, given the absence of any legislative history showing congressional acknowledgment of the exception. Rather, the exception appears to have its origins in lower-level federal courts' decisions that ERISA did not preempt states' efforts to garnish employees' welfare benefits to enforce state child support and alimony decrees.[92] Although the Supreme Court accepts the exception, it has not established any clear guidelines for when the exception will exempt state law from preemption. For example, the Court in *Shaw v. Delta Air Lines, Inc.*,[93] in dicta, referred to the exception in footnote twenty-one, but made no effort to define its boundaries.[94] *Mackey v. Lanier Collection Agency & Service, Inc.*,[95] without specifically citing the exception, made use of it when the Court held that ERISA did not preempt Georgia's generally applicable garnishment law despite a resulting increase in ERISA plans' costs when they are forced to bear the expense of processing state garnishment orders.[96] *District of*

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89. *See Travelers*, 514 U.S. at 661-62. The Court in *Travelers* stated:

> Indeed, to read the pre-emption provision as displacing all state laws affecting costs and charges on the theory that they indirectly relate to ERISA plans that purchase insurance policies or HMO memberships that would cover such services, would effectively read the limiting language in § 514(a) out of the statute, a conclusion that would violate basic principles of statutory interpretation and *could not be squared with our prior pronouncement that "[p]reemption does not occur . . . if the state law has only a tenuous, remote, or peripheral connection with covered plans, as is the case with many laws of general applicability."*

Id. (emphasis added).

90. *See id.* at 668.

91. *See id.* (asserting that New York's surcharges "affect only indirectly the relative prices of insurance policies").

92. *See Shaw*, 463 U.S. at 100 n.21 (citing *AT&T*, 592 F.2d at 118).

93. *See id.*

94. *See id.*

95. 486 U.S. 825 (1988).

96. *See id.* at 842.

Columbia v. Greater Washington Board of Trade,[97] as a part of its general statement of ERISA's governing principles, also cited the exception in dicta, but did not delineate a test for applying it in future cases.[98]

A fourth conceivable implication from *Travelers* is the Court's discounting (and possible rejection) of the "trust fund doctrine" whereby ERISA's preemption has sometimes been found when a state law reduces the funds available to ERISA plans for payment of employee benefits.[99] In *Travelers*, the Court specifically disregarded concerns that New York's surcharges might decrease the funds of those ERISA plans that purchased benefits from more expensive commercial insurers.[100] Some federal courts have adopted *Travelers*' reasoning and have refused to find preemption simply because the application of a state law might result in a reduction of an ERISA plan's benefits.[101]

The fifth and most promising impact of *Travelers* is its statements in support of states' authority to regulate the quality of health care. A reasonable interpretation of *Travelers* is that state quality of care regulations, including common law tort and medical malpractice causes of action, should in appropriate cases survive ERISA preemption. Implicit in such arguments is *Travelers*' reference to the non preemption of states' quality standards.[102] Arguably, this means that, in many cases, medical malpractice lawsuits vindicating physicians' breaches of state medical malpractice laws and doctrines should escape preemption.[103] The non preemption of medical malpractice laws and lawsuits is

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97. 506 U.S. 125 (1992).

98. *See id.* at 130 n.1.

99. *See* Pittman, *supra* note 22, at 427-30.

100. *See Travelers*, 514 U.S. at 661-62. Relying on *Mackey v. Lanier Collection Agency & Serv., Inc.*, 486 U.S. 825 (1988), the *Travelers* Court stated:

> We took no issue with the argument of the Mackey plan's trustees that garnishment would impose administrative costs and burdens upon benefit plans . . . . If a law authorizing an indirect source of administrative cost is not preempted, it should follow that a law operating as an indirect source of merely economic influence on administrative decisions, as here, should not suffice to trigger pre-emption either.

Id. at 662 (citation omitted).

101. *See* Lazorko v. Pa. Hosp., No. 96-4858, 1998 WL 405055, at *2 (E.D. Pa. June 30, 1998), *aff'd in part and vacated in part*, 237 F.3d 242 (3d Cir. 2000).

102. The *Travelers* Court stated:

> Quality standards, for example, set by the State in one subject area of hospital services but not another would affect the relative cost of providing those services over others and, so, of providing different packages of health insurance benefits. Even basic regulation of employment conditions will invariably affect the cost and price of services.
>
> Quality control and workplace regulation, to be sure, are presumably less likely to affect premium differentials among competing insurers, but that does not change the fact that such state regulation will indirectly affect what an ERISA or other plan can afford or get for its money.

Id. at 660-61.

103. *See infra* notes 127-48 and accompanying text.

especially appropriate given that the regulation of physicians' malpractice conduct has traditionally fallen within state law regulation of the medical profession.[104] Therefore, *Travelers*' presumption against the preemption of state police power regulations protects states' malpractice laws and lawsuits from preemption.[105]

In sum, the future legal effect of the trilogy will evolve as courts apply it to new fact patterns while interpreting ERISA's preemption clause and civil enforcement provisions. However, to some extent, the Court's recent ERISA decision in *Pegram v. Herdrich*[106] shows *Travelers*' influence on states' medical malpractice lawsuits.

IV. *PEGRAM V. HERDRICH* AS AN EXTENSION OF *TRAVELERS*

In *Pegram*, the plaintiff, who was a beneficiary under her husband's ERISA benefit plan, alleged that she suffered a ruptured appendix and peritonitis when her treating HMO physician caused her to wait for eight days to have an ultrasound evaluation of her abdomen at an HMO-staffed facility approximately fifty miles away and not at a local hospital, despite the seriousness of her medical condition.[107] Arguably, the plaintiff, in part, contended that the delay in her treatment stemmed from the HMO's desire to save medical treatment expenses by having plaintiff treated at an affiliated medical facility instead of at the local hospital.[108] In addition to state medical malpractice theories, plaintiff alleged a theory under section 409 of ERISA, contending that the contract between the HMO and its affiliated physicians contained a clause that gave physicians a "year-end distribution" financial incentive to ration health care.[109] Apparently, the clause provided for a year-end payment to affiliated physicians based on their meeting established treatment goals.[110] As the foundation of the section 409 theory, the plaintiff alleged that the HMO was an ERISA fiduciary, and that the financial incentive created "an inherent or anticipatory breach" of the HMO's

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104. *See infra* notes 127-48 and accompanying text.

105. Like New York's hospital surcharge regulation, any indirect economic influence that state's medical malpractice lawsuits have on ERISA plans' selection of insurance companies and providers of employee benefits is not dispositive. The primary foreseeable influence of medical malpractice lawsuits is the probability that insurers and their independent utilization reviews will charge ERISA plans more premiums to offset any liability that the former will incur in defending against medical malpractice lawsuits. Such increases in premiums might represent the amount that the insurers and utilization reviews will incur in purchasing liability insurance as protection against such lawsuits. Many insurers and utilization reviews might already be paying for insurance coverage, and therefore, there might not be a substantial increase in employer's and ERISA plan's premiums.

106. 120 S. Ct. 2143 (2000).

107. *See id.* at 2146.

108. *See id.* at 2149.

109. *Id.* at 2150.

110. *See id.*

fiduciary duties under ERISA because it caused the HMO, through its treating physicians, to consider its own financial well-being while making medical treatment decisions for its member-subscribers, in contravention of the HMO's fiduciary duty to "act solely in the interest of beneficiaries."[111]

The Court reversed the Seventh Circuit Court of Appeals' decision that the HMO was acting as an ERISA fiduciary when it treated the plaintiff and that the complained of act stated a claim for relief.[112] The Court held that the HMO's decisions were "mixed eligibility and treatment decisions."[113] The Court further held that an HMO does not act in an ERISA fiduciary capacity while making such decisions; and therefore, a plaintiff cannot bring a breach of fiduciary duty claim under ERISA's civil enforcement provisions.[114] In part, the Court found that allowing a breach of fiduciary duty claim would mostly be redundant of a state medical malpractice claim challenging the same type of financial incentive-induced, substandard medical treatment.[115] Implicitly, the Court recognized that ERISA does not preempt a state medical malpractice claim against an HMO and its treating physicians when the challenged acts involve mixed eligibility and treatment decisions.[116]

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111. *Id.* at 2153.

112. *See id.* at 2148. The Seventh Circuit stated:

> Our decision does not stand for the proposition that the existence of incentives automatically gives rise to a breach of fiduciary duty. Rather, we hold that incentives can rise to the level of a breach where, as pleaded here, the fiduciary trust between plan participants and plan fiduciaries no longer exists (i.e., where physicians delay providing necessary treatment to, or withhold administering proper care to, plan beneficiaries for the sole purpose of increasing their bonuses).

Id.

113. *Id.* at 2155.

114. *See id.* at 2158-59.

115. *See id.*

116. *See id.* The Court stated:

> What would be the value to the plan participant of having this kind of ERISA fiduciary action? It would simply apply the law already available in state courts and federal diversity actions today, and the formulaic addition of an allegation of financial incentive would do nothing but bring the same claim into a federal court under federal-question jurisdiction. It is true that in States that do not allow malpractice actions against HMOs the fiduciary claim would offer a plaintiff a further defendant to be sued for direct liability, and in some cases the HMO might have a deeper pocket than the physician. But we have seen enough to know that ERISA was not enacted out of concern that physicians were too poor to be sued, or in order to federalize malpractice litigation in the name of fiduciary duty for any other reason. It is difficult, in fact, to find any advantage to participants across the board, except that allowing them to bring malpractice actions in the guise of federal fiduciary breach claims against HMOs would make them eligible for awards of attorney's fees if they won . . . But, again, we can be fairly sure that Congress did not create fiduciary obligations out of concern that state plaintiffs were not suing often enough, or were paying too much in legal fees. The

However, there is some uncertainty over *Pegram*'s full scope. Although the Court recognizes that a treating physician's decision that a patient does not need emergency care (or some other type of care) is a mixed eligibility and treatment decision,[117] the Court deferred judgment on whether ERISA's preemption clause would preempt a state law claim challenging an HMO's denial of medical benefits when the decision is a mixed eligibility and treatment decision.[118] However, the Court's extended discussion that the creation of a breach of ERISA fiduciary duty cause of action would be redundant of a state law medical malpractice cause of action is strong indication that ERISA would not preempt such a state law claim.[119] At the very least, the Court has called into question the "standards governing such a claim" and its relationship to a claim for denied benefits under section 502(a) of ERISA's civil enforcement provisions. The Court's decision also raised questions regarding whether ERISA preempts state law claims challenging "a denial of benefits" in light of the Court's conclusion that mixed eligibility and treatment decisions are neither exercises of ERISA

> mischief of Herdrich's position would, indeed, go further than mere replication of state malpractice actions with HMO defendants. For not only would an HMO be liable as a fiduciary in the first instance for its own breach of fiduciary duty committed through the acts of its physician employee, but the physician employee would also be subject to liability as a fiduciary on the same basic analysis that would charge the HMO. The physician who made the mixed administrative decision would be exercising authority in the way described by ERISA and would therefore be deemed to be a fiduciary . . . Hence the physician, too, would be subject to suit in federal court applying an ERISA standard of reasonable medical skill. This result, in turn, would raise a puzzling issue of preemption. On its face, federal fiduciary law applying a malpractice standard would seem to be a prescription for preemption of state malpractice law, since the new ERISA cause of action would cover the subject of a state-law malpractice claim . . . To be sure, [*Travelers*], throws some cold water on the preemption theory; there, we held that, in the field of health care, a subject of traditional state regulation, there is no ERISA preemption without clear manifestation of congressional purpose. But in that case the convergence of state and federal law was not so clear as in the situation we are positing; the state-law standard had not been subsumed by the standard to be applied under ERISA. We could struggle with this problem, but first it is well to ask, again, what would be gained by opening the federal courthouse doors for a fiduciary malpractice claim, save for possibly random fortuities such as more favorable scheduling, or the ancillary opportunity to seek attorney's fees. And again, we know that Congress had no such haphazard boons in prospect when it defined the ERISA fiduciary, nor such a risk to the efficiency of federal courts as a new fiduciary-malpractice jurisdiction would pose in welcoming such unheard-of fiduciary litigation.

Id. at 2158 (internal citations omitted).

117. *See id.* at 2154-55.

118. *See id.* at 2154. The Court stated "[N]or have we reason to discuss the interaction of such a claim with state law causes of the action." *Id.* at 2154 n.9.

119. *See id.* at 2158-59. For a further discussion of *Pegram*'s impact on an ERISA preemption clause analysis, see *infra* notes 316-20 and accompanying text.

fiduciary duties nor actionable breaches of fiduciary duties under ERISA's civil enforcement provisions.[120]

Pegram is encouraging because it relied on *Travelers* for the proposition that in the field of health care, there is no ERISA preemption without a clear manifestation of congressional purpose. In the words of Justice Souter in *Pegram*, *Travelers* "throws some cold water on the preemption theory."[121] A review of lower-level federal courts' decisions also leads to the conclusion that *Travelers* has weakened ERISA's preemption in the health care industry and has led to a better balance between state and federal regulation of medical services.

V. *Travelers* as a Limitation on ERISA's Preemption of State Medical Malpractice Laws and Lawsuits

The Third Circuit's decision in *Dukes v. U.S. Healthcare, Inc.*,[122] has been influential to the extent of its reliance on *Travelers* to limit the scope of ERISA's preemption clause.[123] Importantly, *Dukes* made a distinction between a state law claim seeking a remedy for the poor quality of provided medical benefits and a state claim seeking a remedy for denied benefits.[124] Since section 502 (a) of ERISA's civil enforcement provisions does not provide a remedy for the substandard quality of benefits that a health plan has provided to a beneficiary, the Third Circuit held that the defendants could not remove a state law vicarious liability claim to federal court under the complete preemption doctrine.[125] The

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120. *See Pegram*, 120 S. Ct. at 2154.

121. *Id.* at 2158.

122. 57 F.3d 350 (3rd Cir. 1995). In *Dukes*, the decedent had ear surgery. *See id* at 352. His surgeon ordered a blood test, but defendant hospital, for some reason, would not perform the test. Subsequently, the decedent died. Because his blood sugar was high at the time of death, an allegation was made that the high blood sugar level would have been diagnosed had the hospital performed the test. The plaintiff filed a direct medical malpractice lawsuit against certain of the decedent's treating physicians and treating hospital. Moreover, the plaintiff asserted a vicarious liability claim against the HMO from which the decedent received his medical treatment pursuant to an ERISA benefit plan, alleging that the HMO was responsible for the physicians' negligent actions because the HMO held the physicians out as its employees. *See id.* The plaintiff also alleged direct liability against the HMO on the grounds that it was negligent in its "selecting, retaining, screening, monitoring, and evaluating the personnel who actually provided the medical services." *Id.*

123. Despite *Dukes*' primary issue being whether the plaintiff's state law vicarious liability claims against an HMO should be removed from state court to federal court under the complete preemption doctrine, the court made statements supportive of an expansive application of *Travelers*. *See id.* at 356-58. The Third Circuit held that the state law claims were not completely preempted because they did not fall within the scope of section 502 (a)(1)(B) of ERISA's civil enforcement provisions in that they were not claims seeking denied benefits, nor did the claims seek either to enforce rights under the ERISA plan or to clarify rights under the plan. *See id.*

124. *See id.* at 356-57.

125. *See id.* The court held that the purpose of section 502(a) is to provide beneficiaries with

Dukes court strongly stated that the "[q]uality control of benefits . . . is a field traditionally occupied by state regulation" and that Congress' silence on the issue meant that states should continue to govern the quality of health care.[126] Under the *Dukes* court's reasoning, ERISA should not preempt either a direct liability claim against a treating physician or a vicarious liability claim against an HMO or other managed care organization, when the claims challenge negligent medical treatments, because such claims are traditionally part of the state's regulation of the quality of medical care.

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a cause of action in situations when an ERISA plan or administrator has failed to pay or will fail to pay benefits due under an ERISA welfare benefit plan. *See id.* at 357. First, the Court stated: "On its face, a suit 'to recover benefits due . . . under the terms of [the] plan' is concerned exclusively with whether or not the benefits due under the plan were actually provided. The statute simply says nothing about the quality of benefits received." *Id.*

Second, section 502(a) does not provide a civil cause of action when an ERISA beneficiary receives benefits that are of a substandard quality, as the section's purpose is to prevent denied benefits and remedy claims for denied benefits, and not claims for low quality benefits. *See id.* at 357. The court's analysis is based on its interpretation of ERISA's legislative history:

> Nor does anything in the legislative history, structure, or purpose of ERISA suggest that Congress viewed § 502(a)(1)(B) as creating a remedy for a participant injured by medical malpractice. When Congress enacted ERISA it was concerned in large part with the various mechanisms and institutions involved in the funding and payment of plan benefits. That is, Congress was concerned that "owing to the inadequacy of current minimum [financial and administrative] standards, the soundness and stability of plans with respect to adequate funds to pay promised benefits may be endangered." Thus, Congress sought to assure that promised benefits would be available when plan participants had need of them and § 502 was intended to provide each individual participant with a remedy in the event that promises made by the plan were not kept. We find nothing in the legislative history suggesting that § 502 was intended as a part of a federal scheme to control the quality of the benefits received by plan participants. Quality control of benefits, such as the health care benefits provided here, is a field traditionally occupied by state regulation and we interpret the silence of Congress as reflecting an intent that it remain such.

Id. (citation omitted).

126. *Id.* The court specifically cited *Travelers* as support for this conclusion, which shows the court's interpretation of *Travelers*' limitation on ERISA's preemption. Although the Third Circuit's opinion did not directly involve a decision regarding whether ERISA's preemption clause preempted the state law ostensible agency and directly liability claims, given that complete preemption for removal purposes was the issue, it is reasonable to believe that the court would not find preemption in light of its strong statement that Congress' silence on the issue of the quality of care of ERISA's benefits shows an intent that this area of traditional state authority remain with the states. Such determination could not remain with the states if the court were to find preemption under ERISA. As a matter of fact, if ERISA preempts state law claims for vicarious liability and medical malpractice, quality of care controls of ERISA benefits would not lie anyplace given the absence of a remedy for substandard care under section 502(a) of ERISA's civil enforcement provisions.

A. Low Quality Benefits Versus Denied Benefits—A Direct Liability Claim Against the Treating Physician

ERISA's preemption of state medical malpractice lawsuits depends on the identity of the defendant. It is reasonably clear that ERISA does not preempt a plaintiff's direct malpractice claim against a treating physician even if the plaintiff has chosen the physician from an HMO's list of preferred providers. For example, in *Lancaster v. Kaiser Foundation Health Plan of Mid-Atlantic States, Inc.*,[127] the plaintiff, an eleven-year-old child who had medical coverage

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127. 958 F. Supp. 1137 (E.D. Va. 1997). Plaintiff's treating physicians were members of a group of physicians who had a contract with Kaiser Foundation Health Plan, an HMO that provided medical services to an ERISA plan under which the plaintiff received medical treatment for severe headaches. *See id.* at 1139.

Plaintiff alleged that the treating physicians misdiagnosed her condition because Kaiser Foundation Health Plan, an HMO that provided medical services to plaintiff, and the treating physicians' medical group used bonuses to discourage the treating physicians from ordering medically necessary tests that would have diagnosed the tumor. *See id.* at 1140. The treating physicians had treated plaintiff with medication, but did not order either an EEG or an MRI until approximately four years after plaintiff first sought treatment. *See id.* Plaintiff alleged several acts of negligence:

> (i) Count I (negligence) alleges that Campbell "deviated from the accepted standard of medical care" because, among other things, he "failed to create an appropriate and timely differential diagnosis; failed to timely and properly refer the [patient] to a neurologist; fail[ed] to properly and timely order an MRI, CT Scan, EEG and/or other diagnostic testing; . . . fail[ed] to timely respond to his patient['s] signs and symptoms of a growing brain tumor; and fail[ed] to prescribe and use appropriate drugs in the appropriate dosages of said drugs to treat his patient."
> (ii) Count II (negligence) alleges that Pauls breached his duty to act as a reasonably prudent medical practitioner in the same manner and to the same extent as Campbell.
> (iii) Count III (negligence) alleges that Kaiser "is [indirectly] liable [by virtue of] respondeat superior for the negligence of Campbell and Pauls" and directly liable "for the establishment of guidelines and cost standards which worked against the full and prompt diagnostic assessment [of Lancaster's brain tumor] within the accepted standard of care and for its failure to establish policies, protocols, guidelines and standards for an adequate diagnostic assessment and treatment of [Lancaster's] continuing headaches."
> (iv) Count IV (negligence) alleges that the Medical Group "is liable for the negligence [of Campbell and Pauls by virtue of] respondeat superior" and "is further negligent for the establishment of guidelines and cost standards which work[ed] against [Lancaster] receiving a proper diagnosis and treatment assessment within the standard of care during the course of her treatment for her headaches and for the failure to establish policies, protocols, guidelines and standards for her diagnostic assessment during her hospitalization."
> (v) Count V (actual and constructive fraud) alleges that each defendant . . . "made an

under an ERISA benefit plan, filed a medical malpractice claim against her treating physicians, alleging that the physicians negligently misdiagnosed a brain tumor.[128] Plaintiff also alleged a vicarious liability claim against the HMO that arranged her medical care and against the treating physicians' medical group, asserting that these entities were responsible for the treating physicians' malpractice.[129] The court rejected defendants' allegations that ERISA preempted plaintiff's claim,[130] relying on the *Travelers*' Court's pronouncement that ERISA's preemption clause is not limitless in its application. ERISA did not preempt the two counts alleging medical malpractice against plaintiff's treating physicians, because a malpractice claim is a generally applicable state law claim that does not have a sufficient impact on "the relations among traditional ERISA plan entities, including the principal, the plan, the plan fiduciaries, and the beneficiaries."[131] The court concluded that "[c]ommon law medical malpractice is quintessentially the province of state authority."[132] Consequently, because ERISA did not preempt the medical malpractice claims against the treating physicians, it did not preempt the vicarious liability claims against the HMO and

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> actual misrepresentation of a material fact knowingly and intentionally . . . with the intent to mislead . . . Barbara Lancaster. . . ." Specifically, defendants "represented that they would provide medical care within or exceeding the appropriate standard of care for reasonably prudent practitioners similarly situated . . . [and then, despite] that representation, each defendant herein knowingly and intentionally established policies and guidelines which would financially benefit [Campbell and Pauls] for not providing care as reasonably prudent practitioners similarly situated and that bonuses and/or profit incentives were paid to these physicians for not rendering full and adequate care as needed."

Id. at 1140-41.

128. *See id.* at 1139-40.

129. *See supra* note 127.

130. Before deciding the preemption issue, the court removed plaintiff's state law claim to federal court under the complete preemption doctrine. *See Lancaster*, 958 F. Supp. at 1145.

131. *Id.* at 1149. Several other courts have held that ERISA does not preempt a plaintiff's state law medical malpractice claim against a treating physician, even when the physician was a member of an HMO that administered plaintiff's ERISA plan; these cases primarily use the "too tenuous, remote, or peripheral" exception; the "'run-of-the-mill state law" exception; the presumption against the preemption of traditional state laws exception; and the distinction between a state law claim challenging a denial of benefits and one challenging substandard medical treatment and/or the quality of medical benefits. *See* Pacificare of Okla., Inc., v. Burrage, 59 F.3d 151, 155 (10th Cir. 1995) ("Just as ERISA does not preempt the malpractice claim against the doctor, it should no preempt the vicarious liability claim against the HMO if the HMO has held out the doctor as its agent."); Edelen v. Osterman, 943 F. Supp. 75, 76 (D.C. 1996) (denying preemption of a state law medical malpractice claim against a treating physician, stating that the claim "is one of those 'run-of-the-mill' state claims that has too tenuous a relationship to an employee benefit plan to support a finding of preemption").

132. *Lancaster*, 958 F. Supp. at 1149.

the treating physicians' medical group as alleged in the complaint.[133]

The court's decision in *Lancaster*, and its reliance on *Travelers*, is a reasonable recognition of federalism. States should be allowed to regulate, either through statutory provisions or medical malpractice lawsuits, the conduct of physicians who practice in their territorial boundaries. The *Lancaster* plaintiff's physicians could not practice medicine in the relevant state if they were not licensed to practice medicine there. Having submitted themselves to a state's medical licensure requirements and disciplinary jurisdiction, the treating physicians should hardly be heard to complain that they should not be subject to a medical malpractice lawsuit while treating patients in the state. This is especially true given that states, and not the federal government, regulate the quality of medical practice. Moreover, ERISA has no statutory provisions that either directly regulate the quality of medical care within a particular state or specifically limit a state's authority to regulate the quality of medical care.

Therefore, the lower-level federal cases that make a distinction between the *quality* of provided benefits and the *quantity* of benefits (with ERISA not providing a remedy for the former but providing one for the latter) support a

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133. *See id.* at 1149-50. The court held that any reference to the plan language that would be required to establish the agency relationship between the HMO and the treating physicians was not sufficient to cause preemption because "such reference does not sufficiently implicate the underlying objectives of the ERISA statute." *Id.* at 1150. Further, the vicarious liability claim did not "purport to mandate or regulate an employee benefit plan." *Id.*

First, the court held that the complete preemption doctrine did not provide a basis for removal of plaintiff's state law medical malpractice claims (Count I and II) against the treating physicians, who denied allegations that they committed medical malpractice in their treatment of plaintiff by not ordering appropriate medical tests and by not referring plaintiff to a specialist. *See id.* The reason these claims were not preempted is that the medical malpractice claims attacked the quality of the physicians' medical treatments, and not the HMO's administrative decisions regarding whether to authorize payment for treatment the physicians might have recommended. Furthermore, the medical malpractice claim allegation against the treating physicians that the HMO's and medical group's bonus incentive plan caused the treating physicians to deviate from the acceptable medical standard of care was not sufficient enough to support complete preemption, given that to establish a state medical malpractice claim one must show only a deviation from the standard of care and not necessarily the motivation for the deviation. *See id.* at 1146. In sum, the court reasoned that the complete preemption doctrine was not applicable because the state law claim challenged the physicians' medical decision to not order certain tests and the quality of care of the medical decisions. *See id.* Similarly, and in reliance on *Dukes*' quantity/quality distinction, the court held that the vicarious liability claims against the HMO and the medical group, being based on the state medical malpractice claim against the physicians, was not a proper ground for complete preemption because it also involved the quality of medical decisions and the HMO's and medical group's legal responsibility for these decisions. *See id.* at 1145. Apparently the treating physicians did not ask the HMO for any authorization of the diagnostic tests the plaintiff contends that the treating physicians should have ordered. Therefore, there was no ERISA benefit plan administrative benefit denial decision to serve as the basis of the plaintiff's state law claim regarding the treating physicians' alleged medical malpractice. *See id.*

conclusion that ERISA should not preempt a state law medical malpractice claim against a treating physician because these cases leave the regulation of the quality of medical benefits to the states. The same conclusion is appropriate for vicarious liability claims against HMOs and other managed care organizations that provide treating physicians to patients.

B. Low Quality Benefits Versus Denied Benefits—Vicarious Liability Claims Against HMOs and Health Plans

A vicarious liability claim against an HMO or health plan seeks to hold such entities legally responsible for treating physicians' medical malpractice, normally because the HMO or health plan has mandated that the plaintiff-beneficiary select the treating physician from a restricted list of physicians.[134] To defend a vicarious liability claim, a HMO or health plan will frequently raise an ERISA preemption defense, alleging that the state law claim "relates to" the ERISA plan.[135] Some courts have cited *Travelers* to establish that ERISA does not preempt vicarious liability claims.[136]

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134. In other words, the HMO or health plan gives the beneficiary a preferred list of physicians from which the beneficiary typically must either choose a treating physician or suffer a reduction in the amount the HMO or health plan will pay. *See* Ryan L. Everhart, Comment, *New York Managed Care Legislature: A Substantive Response to Corporate Medicine or a Token Gesture to Ease Consumer Concerns?*, 46 BUFF. L. REV. 507, 516 (1998) ("Upon joining an HMO, the enrollee will usually receive a list of physicians from which he or she may seek treatment. If the enrollee seeks treatment from a different provider, the HMO will often refuse to pay for the services or charge a higher fee.").

135. *See generally* Lazorko v. Pa. Hosp., No. 96-4858, 1998 WL 405055, at *2 (E.D. Pa. June 30, 1998), *aff'd in part and vacated in part*, 237 F.3d 242 (3d Cir. 2000).

136. Although the Fifth Circuit in *Giles v. NYLCare Health Plans, Inc.*, 172 F.3d 332 (5th Cir. 1999), did not determine whether ERISA preempted plaintiff's vicarious liability claim against an HMO for the medical malpractice of one of its preferred provider physicians, the court did hold that the district court had not abused its discretion in remanding the state law claim to state court. *See id.* at 339. The defendants had removed the lawsuit to federal court because plaintiff's lawsuit contained several state law claims that were completely preempted by section 502(a) of ERISA, therefore providing a basis for the district court's exercise of federal subject matter jurisdiction over the claims. *See id.* at 338-39. Once in federal court, the district court granted the defendants' motion to dismiss the completely preempted claims, but the court also granted the plaintiff's motion to remand the vicarious liability claim of the lawsuit to state court given the absence of the completely preempted claims. *See id.* at 335. The Fifth Circuit had jurisdiction to review the district court's remand because it was not a remand under section 1477(c), but was a remand based on the district court's discretionary decision not to exercise supplemental jurisdiction over state law claims that did not independently come within the court's subject matter jurisdiction. *See id.* at 336.

The Fifth Circuit asserted that comity for state court jurisdiction over the state law medical malpractice claim was one factor that supported the district court's decision to remand the lawsuit back to the state court. *See id.* at 339. The crucial consideration on the comity issue was the Fifth

In *Lazorko v. Pennsylvania Hospital*,[137] the plaintiff filed state law claims against U.S.Healthcare, an HMO that arranged for medical care under an ERISA health plan, when the treating physician did not request hospitalization for a wife whose subsequent suicide allegedly resulted from the absence of hospitalization treatment.[138] Although the district court held that ERISA preempted plaintiff's direct liability claim against the HMO,[139] it held that ERISA did not preempt the vicarious liability claim that alleged that the HMO was liable for the medical malpractice of the treating physicians.[140] The court stated:

Circuit's acknowledgment of *Travelers*' conclusion that ERISA should not preempt generally applicable state health law regulations "unless that was the clear and manifest purpose of Congress." *Id.* at 340 (citing N.Y. State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co., 514 U.S. 645, 655 (1995)). Although the Fifth Circuit did not express an opinion on whether ERISA preempted the plaintiff's state law vicarious liability and negligence claims, the court did recognize that these claims were a part of the state's common law regulation of the quality of health care, a matter traditionally left to state law regulation. *See Giles*, 172 F.3d at 339.

To reemphasize, although the Fifth Circuit recognized the comity of the state law regulation of the quality of health care, the court did not express an opinion on whether these comity principles were strong enough for the instant plaintiff's state law claims to escape ERISA's preemption. *See id.* at 339-40. That recognition would not necessarily prevent the Fifth Circuit from subsequently finding preemption; however, the court's acknowledgment of *Travelers*' and states' historical regulation of the quality of health care should cause the Fifth Circuit, and other courts, to engage in a more principled analysis of ERISA preemption issues with a goal towards giving more importance to evaluating the effects that state vicarious liability and medical malpractice lawsuits have on ERISA's preemption clause's objectives and purposes, and less importance on the vague and unhelpful meaning of "relate to."

137. No. 96-4858, 1998 WL 405055, at *2 (E.D. Pa. June 30, 1998), *aff'd in part and vacated in part*, 237 F.3d 242 (3d Cir. 2000).

138. *See id.* "The complaint recites four causes of action: trespass, intentional misrepresentation, fraud, and statutory violation." *Id.*

139. Therefore, in evaluating the HMO's preemption defense, the court emphasized that the plaintiff's complaint had a direct liability claim and a vicarious liability claim against the HMO. *See id.* at *9. The direct liability claim alleged that the HMO's "financial incentive system resulted in an economically motivated decision to refuse [the wife's] needed [hospitalization]," a refusal that caused the wife's suicide. *Id.* The court concluded that this allegation was really a claim for "a denial of plan benefits based upon U.S. Healthcare's administration of the insurance plan." *Id.* Therefore, the court held that the claim was preempted. *See id.* The court also held that plaintiff's claims

> alleging intentional misrepresentation, fraud, and violations of Pennsylvania's Unfair Trade Practices and Consumer Protection Law—all focus on U.S. Healthcare's decisions in administering the relevant benefits plan. Because these counts seek damages under state law for the administration of an ERISA plan, they implicate the statutory objectives of ERISA in a meaningful way and are, therefore, preempted.

Id. (citing *Travelers*, 514 U.S. at 657).

140. *See id.*

> In suing on vicarious liability principles, plaintiff seeks to vindicate rights under state tort law to recover alleged breaches of a physician's duty of care (to the extent that state-law agency principles will impute such a breach to the HMO). This is not a claim to recover damages for the denial of benefits. Nor is it one that otherwise implicates the administration of the plan in a meaningful way since it does not rest on a law that "mandate[s] employee benefit structures or their administration."[141]

Importantly, the court held that any indirect economic effect of the vicarious liability claim, to the extent that the claim would increase the HMO's operating expenses, falls within the "too tenuous, remote, or peripheral" exception to ERISA's preemption.[142] The court also noted that state law medical malpractice claims fall within the presumption against the preemption of traditional state law.[143]

Similarly, the court in *Dykema v. King*[144] held that ERISA did not preempt a plaintiff's vicarious liability and corporate negligence claims because these claims attacked the quality of the medical services that the treating physicians provided and not the quantity of the services.[145] Unlike a state law claim for denied benefits, the plaintiff's "suit rests solely on a failure to provide services

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141. *Id.* (citing *Travelers*, 514 U.S. at 658).

142. *See id.* at *5.

143. *See id.* The court relied on *Travelers*' admonition against the preemption of states' regulation of health care. *Id.* (acknowledging an absence of proof that "Congress chose to displace general health care regulation, which historically has been a matter of local concern"). The court quoted from *Dillingham* that: "Indeed, if ERISA were concerned with any state action—such as medical-care quality standards or workplace regulation—that increased the costs of providing certain benefits, and thereby potentially affected the choices made by ERISA plans, we would scarcely see the end of ERISA's pre-emptive reach . . . ." *Id.*

144. 959 F. Supp. 736 (D. S.C. 1997).

145. *See id.* at 741. Additionally, the claims did not seek either an enforcement of rights under an ERISA benefit plan or a clarification of rights to future benefits under the plan. *See id.* In *Dykema*, the plaintiff brought a vicarious liability claim and a corporate negligence claim against Campion, an HMO that administered a corporation's self-insured welfare benefit plan. *See id.* at 737. After entering into an administration agreement with plaintiff's decedent's husband, who allegedly died of a pulmonary embolism that his treating physicians did not diagnose, the HMO provided the decedent with a list of preferred providers, from which the decedent chose his treating primary care physicians. *See id.* at 738. After seeking treatment on several occasions, the decedent died. *See id.* at 739. The state law vicarious liability claim against the HMO alleged that, under state law, the HMO was vicariously liable for the negligence of the preferred treating physicians who misdiagnosed the decedent's medical condition. *See id.* at 737. The corporate negligence claim was that the HMO "negligently selected and credentialed" the preferred physicians. *Id.* at 739. In evaluating the HMO's motion to remove the state law claim to federal court under the complete preemption doctrine, the court denied removal on the grounds that ERISA did not preempt plaintiff's two state law claims. *See id.* at 741.

of acceptable quality."[146] Therefore, the court denied removal under the complete preemption doctrine.[147]

Lazorko and *Dykema* are consistent with cases holding that ERISA does not preempt a direct medical malpractice lawsuit against a treating physician. Like the direct malpractice claim, the vicarious liability claim is based on a state tort theory that exists independently of the terms and conditions of an ERISA plan. Similarly, vicarious liability claims regulate the quality of medical care to the extent that tort liability might encourage HMOs and other managed care organizations to provide patients with only qualified, non-negligent physicians. Or, the claims might give them an incentive to better monitor physicians' treatment of patients. Being a regulation of the quality of physicians' medical treatment, vicarious liability claims, like direct medical malpractice claims, should escape preemption under the rationale of *Travelers*, *Dukes*, and the above-referenced cases because they are a legitimate state regulation of the quality of medical care.[148]

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146. *Id.*

147. *See id.*

148. Furthermore, to the extent that one believes that enterprise liability is the best way to allocate medical malpractice liability, a vicarious liability claim against an HMO or other managed care organization is more consistent with principles of enterprise liability; and therefore, is another legitimate alternative for state regulation of the quality of medical care. *See generally* Kenneth S. Abraham & Paul C. Weiler, *Enterprise Medical Liability and the Choice of the Responsible Enterprise*, 20 AM. J.L. & MED. 29 (1994) (supporting enterprise liability in the medical profession); Clark C. Havighurst, *Making Health Plans Accountable for the Quality of Care*, 31 GA. L. REV. 587, 587 (1997) ("The thesis of this Article is that MCOs, as distinguished from indemnity-type health insurers, should bear exclusive legal responsibility for the negligence of physicians treating their subscribers or enrollees."). Relying upon the "too tenuous, remote, or peripheral" exception, the insufficient nature of a "reference to" an ERISA plan to establish an agency relationship between HMOs and treating physicians, and the presumption against the preemption of traditional state laws, some cases find that ERISA does not preempt state vicarious liability claims (premised upon treating physicians' medical malpractice) against HMOs and other managed care organizations. Corporate Health Ins. v. Tex. Dep't of Ins., 215 F.3d 526, 534 (5th Cir. 2000) ("Rather, the Act would allow suit for claims that a treating physician was negligent in delivering medical services, and it imposes vicarious liability on managed care entities for that negligence. This vicarious liability does not 'relate to' the managed care provider's role as an ERISA plan administrator or affect the structure of the plans themselves so as to require preemption."); Pacificare of Okla., Inc. v. Burrage, 59 F.3d 151, 155 (10th Cir. 1995) ("Just as ERISA does not preempt the malpractice claim against the doctor, it should not preempt the vicarious liability claim against the HMO if the HMO has held out the doctor as its agent.").

At least one federal circuit court of appeals has found that ERISA preempts a vicarious liability claim against an HMO when the underlying claim against the treating physician alleges that the physician has been negligent in refusing to treat a plaintiff after an HMO has denied medical benefits (as opposed to the physician being negligent in rendering medical treatment that the HMO actually authorized). *See* Jass v. Prudential Health Care Plan, Inc., 88 F.3d 1482, 1494 (7th Cir. 1996) (distinguishing *Pacificare of Oklahoma, Inc*, 59 F.3d at 151, the court stated: "In this case,

Despite strong arguments and good case law support that ERISA does not preempt direct liability and vicarious liability claims, these types of state law claims do not readily cover some negligent medical decisions that cause injuries. In other words, ERISA plan administrators, who make certain medical treatment decisions during the utilization review process, require special consideration under an ERISA preemption analysis.

C. ERISA Administrators' Negligent Utilization Review Decisions and Negligent Medical Treatment Decisions

As with direct medical malpractice claims against treating physicians and vicarious liability claims against managed care organizations, the same reasoning should apply that some of the administrators' negligent decisions during the utilization review process should be subject to state law remedies without ERISA's preemption being a bar. However, state law claims against ERISA administrators run a greater risk of preemption because a limited number of ERISA claims and statutory provisions regulate administrators' conduct and provide a remedy for negligent decisions, albeit a very insubstantial, non-

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however, Dr. Anderson's alleged negligence is intertwined with the benefits determination because the alleged negligence concerned a failure to treat where the Plan denied payment for the treatment."). For cases distinguishing *Jass* on the grounds that it involves a physician's refusal to treat after an HMO denied requested medical benefits, although recognizing that the *Jass* court gave other reasons for preemption, including that the establishment of an agency relationship "would require an analysis of the underlying health care benefit plan and thus would 'relate to' the benefit plan," see *Corporate Health Insurance, Inc.*, 220 F.3d at 643 n.5 (stating the court's opinion that, under Texas' "quality of care" statute, "direct and vicarious liability claim[s] [against HMO] were not preempted when based on the actual negligent provision of medical services."). *See also* Hinterlong v. Baldwin, 720 N.E.2d 313, 323 (Ill. 1999) (distinguishing *Jass* in part on the grounds that it did not involve an HMO's vicarious liability based upon a physician's negligence treatment, but also criticizing that "Jass suffers several infirmities [one of which is that it] completely ignores *Travelers* and engages in the purely textual analysis of [ERISA's preemption clause] called into question by *Travelers*").

For a listing of federal district court opinions that are for and against ERISA's preemption of vicarious liability claims against HMOs, and implicitly applicable to other managed care organizations, see generally *Pryzbowski v. U.S. Healthcare, Inc.*, 64 F. Supp. 2d 361 (D. N.J. 1999). At least one court has summed up the difference between the line of federal district court opinions against preemption and the line in favor of preemption, asserting that the majority of district court cases find no preemption on the grounds that "the medical malpractice claim against the HMO does not sufficiently relate to the plan so as to warrant preemption" and that "the doctor's negligence can be resolved without reference to the plan," while the opposing cases "reason[] that a vicarious liability malpractice claim concerns the delivery of benefits under the plan and the claim requires examination of the plan to determine obligations owed under the plan and the relationship between the plan and plan doctors." *Pacificare of Okla., Inc.*, 59 F.3d at 154-55 (finding that ERISA did not preempt the vicarious liability claim).

compensatory damage remedy.[149]

Some courts have interpreted *Travelers* in a manner that distinguishes between an ERISA administrator's negligent utilization review decision and the administrator's negligent medical decision, with ERISA preempting the former but not the latter. In *Crum v. Health Alliance-Midwest, Inc.*,[150] although primarily involving a removal issue under the complete preemption doctrine, the court held that ERISA did not preempt a state law negligence claim against Health Alliance[151] for its advisory nurses' alleged negligence during the utilization review process in misdiagnosing the decedent's medical condition when his wife spoke to the nurses on the phone regarding the decedent's complaints about chest pain and other symptoms.[152] An advisory nurse, during a phone conversation, allegedly diagnosed the patient as suffering from "excess stomach acid" when he apparently showed symptoms of a heart attack; subsequently, the patient died without receiving any treatment.[153]

The court held that ERISA did not completely preempt the state law claim because it alleged that the ERISA plan administrator was negligent in making a medical treatment decision, and not that the administrator was negligent in a

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149. 29 U.S.C. § 1132(a) ; 29 U.S.C. § 1109(a) (1998).

150. 47 F. Supp. 2d 1013 (C.D. Ill. 1999).

151. *See id.* at 1021. The court's opinion did not specifically state whether Health Alliance was an HMO as opposed to another type of health plan. In any event, under the relevant ERISA plan, Health Alliance employed an advisory nurse who had some responsibility to make utilization review decisions regarding the type of treatments that the plaintiff's decedent needed. *See id.* at 1015.

152. *See id.* at 1015-16, 1017-18.

153. *Id.* at 1015. The major count of plaintiff's decedent's complaint alleged that:

> Defendant, by and through its agents and/or employees, was guilty of one or more [of] the following acts and/or omissions:
>
> a. The advisory nurse or nurses undertook to render a medical diagnosis of [plaintiff's] condition, even though they were not trained, qualified nor licensed to practice medicine in the State of Illinois;
>
> b. The advisory nurse or nurses rendered medical diagnoses of [plaintiff's] condition, even though they were not trained, qualified nor licensed to practice medicine in the State of Illinois; and
>
> c. The advisory nurse or nurses failed to instruct [plaintiff] immediately to seek medical attention at a hospital emergency room.

Id. at 1016. The district court relied on three propositions from *Travelers* to support its decision against preemption of the state law claims. First, the court asserted that it "must look 'to the objectives of the ERISA statute as a guide to the scope of the state law that Congress understood would survive.'" *Id.* at 1017. Second, the court emphasized *Travelers*' conclusion against preemption "if the state law has only a tenuous, remote, or peripheral connection with covered plans, as is the case with many laws of general applicability." *Id.* at 1017-18. Third, the district court stated *Travelers*' assertion that "nothing in the language of [ERISA] or the context of its passage indicates that Congress chose to displace general health care regulation, which historically has been a matter of local concern." *Id.* at 1018.

utilization review decision to grant or deny medical treatment.[154] The district court's decision against preemption rested upon a difference between an ERISA administrator's utilization review decision to deny medical treatment and the administrator's negligent provision of either authorized benefits or medical opinions to beneficiaries.[155] ERISA completely preempts the former claims but not the latter claims under either a direct liability theory or a vicarious liability theory.[156]

However, in some cases, the distinction between an administrator's negligent utilization review decisions and negligent medical treatment decisions is a vague and speculative standard to apply.[157] This might have been the reason why the

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154. *See id.* at 1019.

155. *See id.* at 1020.

156. *See id.* The *Crum* court also held that the ERISA preemption clause did not preempt the claim based upon the nurses' alleged malpractice. *See id.* at 1017-18. This conclusion seems to be the import of the district court's reliance on *Moreno v. Health Partners Health Plan*, 4 F. Supp. 2d 88(D. Ariz. 1998), for the proposition that "[o]ther courts have similarly concluded that [ERISA's preemption clause] does not preempt claims based upon negligence in providing medical services." *Crum*, 47 F. Supp. 2d at 1018. The court in *Crum* also favorably cited cases that establish that "state law provisions making managed care entities liable for substandard health care treatment decisions [are] not preempted by [ERISA's preemption clause]." *Id.* (citing Corporate Health Ins. Inc. v. Tex. Dep't of Ins., 12 F. Supp. 2d 597, 611-20 (S.D. Tex. 1998)). Moreover, the court stated that "ERISA 'does not oblige federal courts to take over the entire subject of medical care.'" *Id.* (citing Cent. States v. Pathology Lab, 71 F.3d 1251, 1254 (7th Cir. 1995)).

157. For example, the facts in *Crum* show that the patient's wife, after the patient experienced symptoms that were consistent with a heart attack, contacted the ERISA plan administrator's advisory nurse whose role was apparently that of a utilization reviewer of requested medical treatment. *See id.* at 1015-16. The district court does not clearly state whether the wife requested the authorization of emergency room treatment. *See id.* at 1015. The district court's statement of the relevant facts is as follows:

> Plaintiff alleged that the advisory nurses were employees of Defendant or acted as Defendant's agents. Plaintiff alleged that, at approximately 10:50 p.m., she contacted an advisory nurse on Gary's behalf and informed the nurse of Gary's symptoms and the history of heart trouble in Gary's family. Plaintiff told the nurse she wanted to make sure Gary was not having a heart attack. The advisory nurse told Plaintiff that Gary's symptoms were probably due to excess stomach acids and that he should be fine. Plaintiff again telephoned an advisory nurse at approximately 11:34 p.m. Plaintiff informed the nurse of Gary's continued symptoms and also that he was experiencing pain in the middle of his chest. According to Plaintiff's Complaint:
>
> The advisory nurse indicated that [plaintiff] should sit at a 40 degree angle, that he should drink some milk and that this would allow the stomach acids to recede and would help with the discomfort, and that he would be fine in the morning, and that he did not need to go to an emergency room.
>
> At 11:55 p.m., Gary's symptoms had not ceased, and Plaintiff decided to drive Gary to a Medical Center. On the way, Gary became unresponsive. Cardiopulmonary resuscitation was performed when Gary arrived at the Medical Center at 12:05 a.m. The

district court in *Crum* stated that "the claims at issue here do not clearly involve 'utilization review' and instead are more accurately considered claims based on the 'quality' of medical care received and a 'medical decision' rather than an administrative decision."[158]

The problems stemming from *Crum* revolve around several issues. First, there is uncertainty over the types of claims that should fall within the quality of care exception to ERISA preemption, as discussed in *Crum*. The resolution of this issue might depend on the nature of a treating physician's recommended treatment and on whether the ERISA administrator's or ERISA utilization reviewer's decision is (1) only a utilization review decision, (2) only a medical decision, or is (3) a "mixed medical and utilization review decision."[159]

> efforts were not successful, and Gary was pronounced dead at 12:29 a.m. The cause of death was later determined to be acute myocardial infarction.

Id. at 1015-16. If the wife had requested treatment, then the advisory nurse's statement that the patient was not suffering from a heart attack and therefore did not need medical treatment would have arguably been a negligent utilization review decision. ERISA's preemption clause would have probably preempted plaintiff's state law claims under the district court's analysis in *Crum*. However, one could conclude that the wife's purpose for telephoning the nurse was to obtain medical advice regarding what should be done in light of the husband's symptoms. If such were the case, then plaintiff's state law claims, being based on an alleged medical decision, would not have been preempted.

Of particular significance is the wife's statement that she "told the nurse she wanted to make sure Gary was not having a heart attack." *Id.* at 1015. The advisory nurse allegedly "told Plaintiff that Gary's symptoms were probably due to excess stomach acids and that he should be fine." *Id.* This appears to indicate that the wife was seeking medical advice and not making a request for an authorization of emergency room treatment.

158. *Id.* at 1020. Cases supportive of a state medical malpractice or vicarious liability claim against an ERISA health plan and/or against a plan's agents and employees, including those involved in the plans' utilization review, generally will not find preemption if the plaintiff's complaint alleges negligence in the provision of benefits and not negligence in the plan's decision to deny benefits. *See* Huss v. Green Spring Health Servs., Inc., No. 98-6055, 1999 WL 225885, at *6 (E.D. Pa. Apr. 16, 1999) (holding that ERISA preempted a plaintiff's state law malpractice claim based on a utilization reviewer's alleged false statement that the plaintiff's son was not covered under the plan because the claim "seeks redress for denial of benefits, caused by inadequate administration of an ERISA covered plan, . . . not quality, of benefit received"); Phommyvong v. Muniz, No. 3:98-CV-0070-L, 1999 WL 155714 (N.D. Tex. Mar. 11, 1999). In *Phommyvong*, ERISA did not preempt a plaintiff's "negligence, breach of contract, and deceptive trade practices" claims against an employer who established an ERISA plan, nor plaintiff's claim against the plan for "expenses for medical care and attention on behalf of their daughter," nor plaintiff's claim alleging that the plan "failed to select and retain competent personnel for the evaluation and treatment of plan members." *Id.* at *1, *3. All claims were based on the death of plaintiff's daughter after a nurse practitioner allegedly failed to diagnose lupus. *See id.* at *1. The court reasoned that the claim was "based upon the quality of care which the daughter received" and not on denied benefits. *Id.* at *3.

159. *Crum*, 47 F. Supp. 2d at 1018-19.

For example, if the treating physician requests a CAT scan and the ERISA plan administrator or utilization reviewer simply denies the request without any comments on the medical necessity of either the requested treatment or some alternative treatment, one could say that the denial of the treatment was "only a utilization review decision" to deny the treatment. Therefore, under some existing case law, ERISA would preempt a patient's state lawsuit against either an ERISA administrator or a utilization reviewer, alleging that a cancer went undiagnosed because the CAT scan was not authorized. Arguably, the administrator's or utilization reviewer's failure to authorize the CAT scan would be a utilization review decision that falls within ERISA's civil enforcement provisions; and ERISA's preemption clause would preempt a state law claim seeking to impose liability on either the administrator or the utilization reviewer pursuant to *Pilot Life*'s preemption of state law claims seeking liability for an improper processing of a request for benefits.[160]

On the other hand, an "only a medical decision" issue might exist if the administrator or utilization reviewer either authorizes a treating physician's treatment request or gives medical advice to a patient. In that event, under *Crum*'s and *Dukes*' rationale, ERISA should not preempt a state law claim, against either the treating physician, the ERISA administrator, or the utilization reviewer, that asserts that the treatment was a negligent treatment. For example, if the treating physician requests and the ERISA administrator or utilization reviewer authorizes a CAT scan and the CAT scan is a negligent treatment, ERISA would not preempt a state law claim against the treating physician. There would be no preemption because the claim challenges the quality of provided medical benefits, as the treating physician would be liable under state medical malpractice laws for recommending and using a substandard procedure. In addition, a claim against the ERISA utilization reviewer or administrator could be based upon *Dukes*' distinction that allows state law regulation of utilization reviewer's and administrator's decisions during their role as the arrangers of medical treatment.[161] Assuming the presence of an arranger or provider of medical treatment status, at least two possible state law malpractice claims could be filed against utilization reviewers and administrators. One claim would seek to hold these entities vicariously liable for the treating physician's malpractice.[162] Another would impose corporate negligence liability for their negligence in selecting, monitoring, and supervising the treating physician.[163] The claim against the administrator and utilization reviewer could also be based upon *Crum*'s holding that a utilization reviewer and an administrator can be liable for giving negligent medical advice without ERISA preempting such state law claims. These claims would assert direct liability against administrators and utilization reviewers for their decisions in authorizing negligent medical treatments, especially if they gave medical opinions or advice that either the

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160. *See* Andrews-Clarke v. Travelers Ins. Co., 984 F. Supp. 49 (D. Mass. 1997).

161. *See, e.g.*, Dukes v. U.S. Healthcare, Inc., 57 F.3d 350, 356-57 (3rd Cir. 1995).

162. *See id.*

163. *See id.*

patient's physician or the patient herself relied upon to the patient's detriment.[164]

A "mixed medical and utilization review decision" would exist if, in addition to denying the requested CAT scan treatment, the administrator or utilization reviewer asserted that either the CAT scan was not medically necessary, that some other treatment was appropriate, or that no treatment at all was required. Furthermore, either the patient or the physician must have relied on the administrator's or utilization reviewer's medical advice to the patient's detriment. The resolution of an ERISA preemption issue in this type of situation appears more problematic than the two scenarios discussed above. The *Crum* court apparently would separate the administrator's or utilization reviewer's decision into a utilization review component (the denial of the medical treatment) and a medical decision component (opinions or advice regarding the medical necessity of the treatment). Under *Crum*, ERISA would not preempt a state law claim challenging only the quality of the medical decision, but a state lawsuit challenging a utilization review decision that denied medical treatment would likely be preempted.[165]

However, some courts refuse to distinguish between negligent medical decisions and negligent utilization review decisions, opting instead to find preemption because the medical decision occurred during the processing of a claim for ERISA benefits. For example, in *Andrews-Clarke v. Travelers Insurance Co.*,[166] the plaintiff was the personal representative of Richard Clarke, an alcoholic who committed suicide when an ERISA plan's utilization reviewer would not authorize appropriate hospitalization for treatment of his alcoholism.[167] Despite an ERISA plan provision granting Clarke "at least one thirty day inpatient rehabilitation program per year," the utilization reviewer authorized only five days of hospitalization for Clarke's first treatment.[168] During a second hospitalization approximately thirty days later, the utilization reviewer authorized only eight days of care, despite Clarke's continued drunkenness and the benefit plan provision that would have allowed thirty days of care.[169] At the end of that hospitalization and "less than twenty-four hours later," Clarke again consumed a large quantity of alcohol and attempted suicide by locking himself in a garage with his car engine running.[170] After being rescued by his wife, Clarke was hospitalized and successfully treated for "carbon monoxide poisoning."[171]

Subsequently, a judge had Clarke involuntarily committed to prison for "his detoxification and rehabilitation" when the utilization reviewer, "despite the fact that enrollment in a thirty-day inpatient detoxification program is a defined benefit of the Travelers insurance policy, incredibly refused to authorize such a

164. *See Crum*, 47 F. Supp. 2d at 1019.
165. *See id.*
166. 984 F. Supp. 49 (D. Mass. 1997).
167. *See id.* at 50-52.
168. *Id.* at 51.
169. *See id.*
170. *Id.*
171. *Id.*

private admission."[172] Once in the prison, Clarke "was forcibly raped and sodomized by another inmate in his unit."[173] Unfortunately, the prison did little to treat Clarke's alcoholism condition.[174] Approximately one month later, Clarke was arrested for drunkenness and then admitted to another hospital which offered neither treatment for Clarke's alcoholism nor a transfer to another facility for alcohol treatment.[175] After being release the next morning, Clarke "purchased a six-pack of Meisterbrau beer "and consumed it."[176] Shortly thereafter, the police found his dead body in a parked car "with a garden hose extending from the tailpipe to the passenger compartment."[177]

Subsequently, the wife filed a lawsuit against Travelers, the administrator of the welfare benefit plan and against Greenspring, the utilization reviewers that allegedly denied Clarke sufficient hospitalizations on several occasions.[178] Alleging that Clarke's death "was the direct and foreseeable result of the improper refusal of Travelers and its agent Greenspring to authorize appropriate medical and psychiatric treatment during Clarke's repeated hospitalizations for alcoholism," Clarke's wife asserted theories of liability for "breach of contract, medical malpractice, wrongful death, loss of parental and spousal consortium, intentional and negligent infliction of emotional distress, and specific violations of the Massachusetts consumer protection laws."[179]

Although the federal district court showed righteous indignation against the harshness of ERISA preemption and acknowledged that ERISA should be amended to punish the type of improper denial of treatment that Clarke was forced to endure, the court held that ERISA preempted all of the wife's claims.[180] First, the court, in part relying upon *Corcoran v. United Health Care, Inc.*,[181] held that ERISA preempted the wife's claim because it "[arose] out of the alleged improper processing of Clarke's claim for benefits under an ERISA employee benefit plan."[182] The court used the same basic rationale as the Fifth Circuit in *Corcoran* by finding that *Pilot Life*, which held that ERISA preempts state law

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172. *Id.*

173. *Id.*

174. *See id.*

175. *See id.* at 51-52.

176. *Id.* at 52.

177. *Id.*

178. *See id.*

179. *Id.*

180. *See id.* at 53. The court expressed its concern by stating:

> ERISA is a "comprehensive statute designed to promote the interests of employees and their beneficiaries in employee benefit plans." . . . It is therefore deeply troubling that, in the health insurance context, ERISA has evolved into a shield of immunity which thwarts the legitimate claims of the very people it was designed to protect. What went wrong?

Id. at 56.

181. 965 F.2d 1321 (5th Cir. 1992).

182. *Andrews-Clarke*, 984 F. Supp. at 53-54.

claims for improper processing of ERISA welfare benefit claims, is broad enough to encompass a utilization reviewer's negligent decision during the processing of a claim even if the negligent act involves a medical decision that the recommended treatment is not medically necessary.[183] In other words, it appears that the *Andrews-Clarke* court believed that all decisions by a utilization reviewer that occur during the processing of a benefit claim warrant ERISA preemption of all state law claims challenging such decisions because the utilization reviewer's decision "relates directly to . . . [the] administration of benefits."[184]

The court reached this conclusion despite its recognition of *Travelers*' admonition that ERISA's preemption clause's text is "unhelpful," and that courts must examine ERISA's objectives to clearly understand the scope of its preemption.[185] In an effort to reconcile its decision with *Travelers*' limitation on ERISA's preemption, the court stated that *Travelers* "made clear that [the Court's] prior ruling in *Pilot Life* remains good law."[186] Applying *Pilot Life* and *Corcoran*, the court held that "[un]like the hospital surcharge statute at issue in *Travelers*, which had only an indirect economic influence on plan administration, here [the wife's] claims go right to the heart of the benefit determination process."[187] Concentrating on *Corcoran*'s rationale, the court reasoned that allowing this state law claim would create the type of disuniformity in the administration of ERISA benefit plans that ERISA's preemption clause sought to prevent.[188]

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183. *See id.* at 54 n.23.

184. *Id.* at 56 (quoting Kuhl v. Lincoln Nat'l Health Plan of Kansas City, Inc., 999 F.2d 298, 302-03 (8th Cir. 1993), *cert. denied*, 510 U.S. 1045 (1994)).

185. *Id.* at 57.

186. *Id.* at 58.

187. *Id.*

188. *See id.* The court stated:

> This Court acknowledges that, in adopting ERISA's preemption provision, Congress intended to relieve employers and ERISA plans from the burdens of compliance with conflicting state laws not as an end in and of itself, but rather as a means to promote the principal object of ERISA as a whole—to protect plan participants and beneficiaries. At the time of its enactment, however, ERISA did provide an adequate remedy for the wrongful denial of health benefits. The present gap in remedies is therefore attributable not to an overbroad application of ERISA's preemption clause, but rather to the failure of Congress to amend ERISA's civil enforcement provision to keep pace with the changing realities of the health care system.

Id. at 58. The court seemed to believe that avoiding a disuniformity of regulation, ERISA's secondary goal, is "ancillary to the first" goal of protecting plan participants and administrators." *Id.* at 58 n.44. Although the court did not explain the full significance of this observation, it appears that the court believed that avoiding a disuniformity of regulation would reduce the cost of operating welfare benefits plans, and therefore, either would not discourage employers from establishing or maintaining benefit plans or would not cause employers to cut back on the level or amount of benefits to offset an increase in the cost of operating benefit plans that might result from a disuniformity of state law regulation. This appears to be the rationale that the Fifth Circuit used

Despite holding that ERISA preempts state causes of action for managed care organizations' negligent decisions during utilization review and that ERISA does not supply an appropriate remedy that provides suitable relief, the *Andrews-Clarke* court did not criticize the Supreme Court's expansive interpretation of ERISA's preemption clause. Instead, the court believed that the problem was Congress' failure to amend ERISA to accommodate negligent decisions made during prospective utilization review, a practice that was not common at the time Congress enacted ERISA.[189]

Although the *Andrews-Clarke* court recognized that the "larger issue" was the changing nature of managed care from a retrospective payment system to a prospective payment system with "the incentives for undercare which now pervade American's health care system," the court thought it best to allow managed care organizations to continue to make utilization review decisions on a case-by-case basis, but to hold them "legally accountable for the consequences of their decisions."[190] In light of ERISA's preemption of state laws and lawsuits and the inadequacy of present ERISA civil enforcement remedies, the court believed that the proper solution was for Congress to amend ERISA to provide for a cause of action for negligent utilization review decisions.[191] The court asserted that "[u]nder any criterion, however, the shield of near absolute immunity now provided by ERISA simply cannot be justified."[192]

Given the adamant nature of Judge Young's opinion, one can conclude that he sincerely understood the injustice of ERISA's preemption of state law claims, especially the adverse incentives of prospective utilization review. Moreover, one can empathize with his efforts to maintain his judicial oath to follow U.S. Supreme Court precedent, which includes the Court's *Pilot Life* decision.[193]

Judge Young addressed cases holding that managed care organizations can be vicariously liable under state law for the medical malpractice of their treating physicians without ERISA preemption.[194] However, he limited the application of these cases to a situation where the plaintiff alleges that a managed care organization is vicariously liable for the primary medical malpractice of an employee physician, as in a staff model HMO, or an independent contractor physician, as in a managed care organization's holding out of a treating physician as its agent.[195] In comparison, Judge Young noted that in *Andrews-Clarke* the plaintiff alleged that the plan administrator, and the utilization reviewer were directly liable "for negligent medical decisions made during the utilization

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in *Corcoran*. *See* Corcoran v. United Health Care, Inc., 965 F.2d. 1321, 1333 (1992).

189. *See Andrews-Clarke*, 984 F. Supp. at 58.

190. *Id.* at 62, 62-63.

191. *See id.*

192. *Id.* at 63.

193. *See id.* at 60. Judge Young stated: "This Court can neither simply disregard its sworn oath to comply with the opinions of the Supreme Court, nor can it 'legislate by judicial decree nor apply a statute, such as ERISA, other than as drafted by Congress.'" *Id.*

194. *See id.* at 56 n.27.

195. *See id.*

review process" and not that they were vicariously liable for physicians' or hospitals' negligent treatment decisions, a difference which apparently supported his conclusion in favor of preemption.[196]

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196. *Id.* at 52. Judge Young's conclusion, that ERISA preempts state law claims seeking to impose liability on managed care organizations for negligent decisions during utilization review, is consistent with earlier legal opinions involving similarly state law claims. For example, in *Foster v. Blue Cross & Blue Shield of Michigan*, 969 F. Supp. 1020 (E.D. Mich. 1997), the plaintiff sued Blue Cross for its failure to pay for an autologous bone marrow transplant for his wife who had breast cancer. *See id.* at 1023. Blue Cross denied the treatment, allegedly because it was experimental. *See id.* The wife died after Blue Cross' denial. *See id.* Despite the court's recognition that *Travelers* held that ERISA's preemption clause text is "unhelpful," the court opined that the clause still has an expansive interpretation. *Id.* Applying the "connection with" and "reference to" definition of "relate to," the court held that ERISA preempted plaintiff's breach of contract, bad faith, inflection of emotional distress, negligent misrepresentation, fraud, and wrongful death claims which sought to hold Blue Cross liable for denying treatment. *See id.* at 1024. The court asserted that "[p]laintiff's state common law claims all arose out of Defendant's allegedly wrongful denial of benefits . . . [and therefore] are preempted by ERISA." *Id.* at 1025. For its conclusion, the court primarily relied on *Kuhl v. Lincoln National Health Plan of Kansas City, Inc.*, 999 F.2d 298 (8th Cir. 1993). *Foster*, 969 F. Supp. at 1024-25. The court also found that preemption was proper because ERISA's civil enforcement provisions provided a remedy, despite the fact that the provisions left plaintiff "without a meaningful remedy." *Id.* at 1024 (quoting Tolton v. Am. Biodyne, Inc., 48 F.3d 937, 943 (6th Cir. 1995)).

However, the court held that ERISA did not preempt the Michigan Blue Cross' enabling law that mandated that "a health care corporation shall offer or include, in each group and non-group certificate, coverage for breast cancer diagnostic services, breast cancer outpatient treatment services, and breast cancer rehabilitative services." *Id.* at 1026. Similarly, ERISA did not preempt another portion of the enabling law that mandated that nonprofit health corporations, like Blue Cross, provide "coverage for antineoplastic therapy" under certain circumstances. *Id.* The court held that, like the surcharges in *Travelers*, the enabling law neither regulated ERISA plans nor dictated the administration of those plans since ERISA plans were still free to choose plans other than Blue Cross plans, thereby avoiding any increase in cost because of Blue Cross's compliance with Michigan's enabling laws. *See id.* at 1027. Additionally, the court held that, even if the enabling laws fell within the scope of ERISA's preemption clause, ERISA's saving clause would have saved those laws from preemption. *See id.* at 1028.

However, the court held that ERISA preempted the portions of the enabling law that allowed a cause of action for misrepresentation of facts regarding a health plan and that provided a cause of action for a "[refusal] to pay claims without conducting reasonable investigation based upon the available information" because these provisions related to the ERISA plans apparently because ERISA's civil enforcement provision provided a similar cause of action for "the wrongful' denial of coverage." *Id.* at 1028. Furthermore, ERISA's saving clause did not exempt these provisions from preemption because they did not satisfy the relevant saving clause test. *See id.*

The distinction that Judge Young made in *Andrews-Clarke* about medical decisions during the utilization review process, as opposed to a claim that seeks to hold a managed care organization vicariously liable for the medical malpractice of a treating physician, can be used to distinguish other cases that have found that ERISA did not preempt a state law malpractice claim. For

Elsewhere this Author has argued that ERISA should not preempt all state law malpractice claims that challenge decisions that occur during the utilization review process.[197] Therefore, *Crum*, which separates negligent medical decisions from negligent utilization review decisions, finding no preemption when state lawsuits challenge a negligent medical decision, appears to be more in line with *Travelers*' criticism of ERISA's vague preemption clause. *Crum* recognizes *Travelers*' conclusion that the regulation of the quality of medical decisions falls within states' traditional police power regulation. As such, *Crum*, more than *Andrews-Clarke*, seems to give appropriate deference to the federalism concerns that *Travelers* promotes through its presumption against the preemption of traditional state law regulations.

However, *Crum* falls short because it fails to state whether ERISA should preempt a mixed eligibility and treatment decision. Given *Pegram*'s conclusion that such mixed eligibility and treatment decisions are not a part of a managed care organization's fiduciary duties under ERISA, and that a beneficiary cannot bring a breach of fiduciary duty claim against such entities under ERISA's civil enforcement provisions, one should be able to bring a state law medical malpractice claim to challenge negligent mixed eligibility and treatment decisions, especially when either a managed care organization, its affiliated

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example, one can look at *Ray v. Value Behavioral Health, Inc.*, 967 F. Supp. 417 (D. Nev. 1997), as a case involving the negligent rendition of medical treatment that had already been approved by the ERISA plan administrator, instead of any alleged negligence that occurred during the utilization review process of deciding whether or not to authorize treatment. *See id.* at 419. In *Ray*, the plaintiff alleged that a psychological counselor mistreated her by making oppressive sexual advances that worsened her psychological condition. *See id.* at 418-19. She filed a claim alleging theories of negligence by a professional counselor, breach of fiduciary duty, intentional infliction of emotional distress, negligent infliction of emotional distress and invasion of privacy. *See id.* at 419. The court held that ERISA did not preempt those claims because they did not have a reference to an ERISA plan since the counselor's alleged impermissible conduct would have happened whether or not there was an ERISA plan. *See id.* at 423. Similarly, plaintiff's state law claims did not have a connection with an ERISA plan because, given Congress' intent, these claims were "exactly the sort of generally applicable personal injury laws that [ERISA's preemption clause] does not preempt." *Id.* The court reasoned that "[s]tate tort laws of general applicability are matters of local concern which impose only indirect economic effects and costs on health plans." *Id.* Mindful of federalism, the court held that:

> To hold that such claims are preempted by ERISA would federalize all tort claims on behalf of plaintiffs who obtain medical treatment through ERISA insurance plans. This Court will not impose such a sweeping federalization of basic personal injury claims in the absence of any language in the text of ERISA or in the absence of any evidence of Congressional intent.

Id. However, the court did assert that preemption might be proper if state law duties cannot be distinguished from ERISA imposed duties, or if the proof of such claims necessitated a reference to an ERISA plan or if the state law claims "are intertwined with an ERISA plan, or that the parties must refer to the plan, its language or coverage to prove or disprove" plaintiff's claim. *Id.* at 424.

197. *See* Pittman, *supra* note 22.

utilization reviewers, or its treating physicians have made the negligent decision. This is tantamount to recognizing that the medical decision portion of a mixed eligibility and treatment decision predominates over the eligibility decision. This is an appropriate conclusion because, in the absence of federal regulation of the quality of medical decisions, state law regulation in this area is not only appropriate but in furtherance of the presumption against the preemption of state law regulation in areas of traditional state concern.

D. States' Quality of Care Statutes

In addition to state regulation of managed care organizations, utilization reviewers, and ERISA benefit administrators through medical malpractice lawsuits and common law tort principles as discussed above, a state might enact a statute to govern the quality of medical care that managed care organizations give their patients. To defend against a lawsuit based on the failure to comply with such a state statute or to guard against other penalties for a violation of the statute, an ERISA administrator and an affiliated managed care organization might raise an ERISA preemption defense when an ERISA benefit plan provides the patient's treatment. At least one court has held that ERISA does not preempt a state statute that establishes the standard of care to which a managed care organization must adhere.

In *Corporate Health Insurance v. Texas Department of Insurance*,[198] the issue was whether ERISA preempts Texas' Health Care Liability Act ("Act"), which has several provisions dealing with two broad aspects of managed care. The "quality of care" provision sets an ordinary care standard to which "health insurance carriers, [HMOs and] other managed care entit[ies]" must adhere "when making health care treatment decisions."[199] In addition, it imposes civil liability for injuries flowing from a violation of the standard.[200] The "benefit

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198. 12 F. Supp. 2d 597 (S.D. Tex. 1998).

199. *Id.* at 603. The court cited relevant portions of the Act:

> (a) A health insurance carrier, health maintenance organization, or other managed care entity for a health care plan has the duty to exercise ordinary care when making health care treatment decisions and is liable for damages for harm to an insured or enrollee proximately caused by its failure to exercise such ordinary care.
>
> (b) A health insurance carrier, health maintenance organization, or other managed care entity for a health care plan is also liable for damages for harm to an insured or enrollee proximately caused by the health care treatment decisions made by its:
>
> (1) employees;
>
> (2) agents;
>
> (3) ostensible agents; or
>
> (4) representatives who are acting on its behalf and over whom it has the right to exercise influence or control or has actually exercised influence or control which result in the failure to exercise ordinary care.

TEX. CIV. PRAC. & REM. CODE ANN. §§ 88.002(a) and (b) (West 1998).

200. *See id.*

review" provisions establish an elaborate independent review system for review of a managed care organization's negative benefit denial decisions.[201] The

201. *See Corporate Health Ins.*, 12 F. Supp. 2d at 622-24. The provisions provide:
(a) A person may not maintain a cause of action under this chapter against a health insurance carrier, health maintenance organization, or other managed care entity that is required to comply with the utilization review requirements of Article 21.58A, Insurance Code, or the Texas Health Maintenance Organization Act (Chapter 20A Vernon's Insurance Code), unless the affected insured or enrollee or the insured's or enrollee's representative:
(1) has exhausted the appeals and review applicable under the utilization review requirements; or
(2) before instituting the action:
(A) gives written notice of the claim as provided by Subsection (b); and
(B) agrees to submit the claim to a review by an independent review organization under Article 21.58A, Insurance Code, as required by Subsection (c).
(b) the notice required by Subsection (a)(2)(A) must be delivered or mailed to the health insurance carrier, health maintenance organization, or other managed care entity against whom the action is made not later than the 30th day before the date the claim is filed.
(c) The insured or enrollee or the insured's or enrollee's representative must submit the claim to a review by an independent review organization if the health insurance carrier, health maintenance organization, or managed care entity against whom the claim is made requests the review not later than the 14th day after the date notice under Subsection (a)(2)(A) is received by the health insurance carrier, health maintenance organization, or other managed care entity. If the health insurance carrier, health maintenance organization, or other managed care entity does not request the review within the period specified by this subsection, the insured or enrollee or the insured's or enrollee's representative is not required to submit the claim to independent review before maintaining the action.
(d) Subject to Subsection (e), if the enrollee has not complied with Subsection (a), an action under this section shall not be dismissed by the court, but the court may, in its discretion, order the parties to submit to an independent review or mediation or other nonbinding alternative dispute resolution and may abate the action for a period of not to exceed 30 days for such purposes. Such orders of the court shall be the sole remedy available to a party complaining of an enrollee's failure to comply with Subsection (a).
(e) The enrollee is not required to comply with Subsection (c) and no abatement or other order pursuant to Subsection (d) for failure to comply shall be imposed if the enrollee has filed a pleading alleging in substance that:
(1) harm to the enrollee has already occurred because of the conduct of the health insurance carrier, health maintenance organization, or managed care entity or because of an act or omission of an employee, agent, ostensible agent, or representative of such carrier, organization, or entity for whose conduct is liable under Section 88.002(b); and
(2) the review would not be beneficial to the enrollee, unless the court, upon motion by a defendant carrier, organization, or entity finds after that such pleading was not made in good faith, in which case the court may enter an order pursuant to Subsection (d).
(f) If the insured or enrollee or the insured's or enrollee's representative seeks to exhaust

federal district court held that ERISA did not preempt the quality of care provision.[202] The court found three reasons why the Act did no have a "reference to" ERISA plans. First, the conditions of the "quality of care" provisions apply to health insurers and managed care entities whether or not they were providing benefits under an ERISA plan.[203] Second, unlike the case *District of Columbia v. Greater Washington Board of Trade*,[204] the Act is not "premised on the existence of an ERISA plan."[205] Third, "the existence of any ERISA plan [is] not essential to the operation of the Act."[206]

> the appeals and review or provides notice, as required by Subsection (a), before the statute of limitations applicable to a claim against a managed care entity has expired, the limitations period is tolled until the later of:
>
> (1) the 30th day after the date the insured or enrollee or the insured's or enrollee's representative has exhausted the process for appeals and review applicable under the utilization review requirements; or
>
> (2) the 40th day after the date the insured or enrollee or the insured's or enrollee's representative gives notice under Subsection (a)(2)(A).
>
> (g) This section does not prohibit an insured or enrollee from pursuing other appropriate remedies, including injunctive relief, a declaratory judgment, or relief available under law, if the requirement of exhausting the process for appeal and review places the insured's or enrollee's health in serious jeopardy.

TEX. CIV. PRAC. & REM. CODE ANN. § 88.003 (West 1998).

202. *See Corporate Health Ins.*, 12 F. Supp. 2d at 620.

203. *See id.* at 612. The court also emphasized that the Act, which "requires managed care entities to exercise ordinary care when making medical decisions[,] . . . excludes ERISA plans from the definition of a 'managed care entity.'" *Id.* However, some courts might interpret such a specific exclusion of ERISA plans as an impermissible protection of ERISA plans that would be sufficient to meet the requirement of a "reference to" to result in preemption under ERISA's preemption clause. *See* Mackey v. Lanier Collecting Agency & Serv., Inc., 486 U.S. 825, 825 (1988) (holding that the garnishment statute, "which singles out ERISA employee welfare benefit plans for different treatment than non-ERISA welfare plans under state garnishment procedures, is pre-empted under § 514(a) of ERISA").

204. 506 U.S. 125 (1992).

205. *Corporate Health Ins.*, 12 F. Supp. 2d at 611 (quoting Cal. Div. of Labor Standards Enforcement v. Dillingham Constr., Inc., 519 U.S. 316 (1997)). The court stated:

> Contrary to Plaintiffs' contention, in *Greater Washington*, the Supreme Court did not conclude that the statute referred to ERISA plans simply because it contained certain terminology. Rather, as explained in [*Dillingham Construction*], the Court reasoned that the reference to ERISA plans resulted in preemption because the existence of ERISA plans was essential to the statute's operation. Unlike the statute in *Greater Washington*, the Act is not premised on the existence of an ERISA plan. It merely requires health insurance carriers, HMOs, and other managed care entities to exercise ordinary care when making medical decisions. The Act imposes this standard on these entities without any reference to or reliance on an ERISA plan.

Id. at 613 (internal citations omitted).

206. *Id.* at 614.

The district court also held that the "quality of care" provisions did not have an impermissible "connection with" an ERISA plan.[207] First, a lawsuit under the Act would "relate to the quality of benefits received from a managed care entity when benefits are actually provided, not denied."[208] Therefore, the district court used *Dukes*' distinction, between a lawsuit for denied benefits and one complaining about the quality of benefits that the administrator has already provided in her role as an arranger and provider of medical care, to hold that the quality of care provisions did not have a "connection with" ERISA plans.[209]

Additionally, the district court concluded that the Act's "quality of care" provisions fell within a "field traditionally occupied by state regulation" and that, as Congress has not specifically addressed the issue, Congress' silence indicates its desire to leave to states the regulation of the quality of provided benefits.[210]

The district court also concluded that the "quality of care" provisions, and lawsuits premised thereon, did not establish an impermissible alternative enforcement procedure for obtaining denied ERISA benefits.[211] This is true because a state lawsuit based upon a substandard quality of care under the Act would be based upon the provision of substandard benefits and not on the denial of benefits.[212] Therefore, the lawsuit would not be seeking the same type of remedies allowable under ERISA's civil enforcement provisions, and would not result in a duplicate, and improper alternative means of obtaining denied benefits.[213]

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207. *Id.* at 620.

208. *Id.* at 617. The court distinguished *Corcoran v. United Health Care, Inc.*, 965 F.2d. 1321 (1992), on the grounds that the plaintiff sought state law remedies for a medical decision that resulted in a denial of benefits. *See Corporate Health Ins.*, 12 F. Supp. 2d at 617. Therefore, *Corcoran* is not a case seeking damages for the provision of low quality or substandard benefits, but a decision "made in relation to the denial of certain plan benefits." *Id.*

209. *See Corporate Health Ins.*, 12 F. Supp. 2d at 618-19. The court stated:

> Also in *Dukes*, the Court distinguished the *Corcoran* case based on the dual roles that may be assumed by an HMO. The Court emphasized that in *Corcoran*, United only performed an administrative function inherent in the utilization review whereas the defendant HMOs in *Dukes* played two roles—the utilization review role and the role as an arranger for the actual medical treatment for plan participants. [U]nlike Corcoran, [in Dukes] there . . . [was] no allegation . . . that the HMOs denied anyone any benefits that they were due under the plan. Instead, the plaintiffs [in *Dukes* were] . . . attempting to hold the HMOs liable for their role as the arrangers of their decedents' medical treatment. Likewise, a plaintiff bringing suit under the Act may seek to hold a HMO liable in its position as the arranger of poor quality medical treatment, thereby, avoiding any allegation that the HMO wrongfully denied benefits under the plan and therefore, any connection with ERISA.

Id. at 619 (internal citations omitted).

210. *Id.* at 620.

211. *See id.* at 628-29.

212. *See id.*

213. *See id.*

In reaching its decision, the court distinguished *Corcoran* on the ground that the Fifth Circuit had not taken into consideration *Travelers*' statements that there should be a presumption against the preemption of state laws in areas of traditional state regulation unless there is a clear and manifest intent of Congress that preemption should occur.[214] Also, in response to the Fifth Circuit's statement in *Corcoran* that the plaintiff's lawsuit would have caused an impermissible disuniformity in the regulation of ERISA plans' utilization review procedures, the court relied on *Travelers*' statements that "an 'indirect economic influence . . . does not bind a plan administrator to any particular choice and thus function as a regulation of an ERISA plan itself.'"[215] In other words, the court in *Corporate Health Insurance* held that despite the prospects of civil liability for negligent decisions under the Act's provisions, health plans were still free to choose the manner and means of providing their benefits to beneficiaries.[216]

On appeal to the Fifth Circuit, the court of appeals, in part, affirmed the district court's opinion on different grounds. First, the Fifth Circuit asserted that the Supreme Court's "presumption-objectives trilogy" represents "the Court's [] returning to a traditional analysis of preemption, asking if a state regulation frustrated the federal interest in uniformity."[217] The court opined that "a broader reading of 'relate to' would sweep away common state action with indirect

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214. *See id.* at 616-17.

215. *Id.* at 617 (quoting N.Y. State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co., 514 U.S. 645, 659 (1995)).

216. *See id.* However, the court found that ERISA preempted the Act's "benefit review" provisions that established procedures for the review of an ERISA administrator's denial of benefits. *See id* at 625. The primary feature of the benefit review procedure was a beneficiary's right to have an "independent review" of an administrator's negative benefit decision. *See id* at 621-22. The court held that ERISA preempted the benefit review provisions because the procedures "improperly mandate the administration of employee benefits and therefore, have a connection with ERISA plans." *Id.* at 625. The apparent reason for preemption was that the review procedures impose certain administrative requirements on ERISA plans which mandated the manner in which the plans must administer themselves during the review of negative benefits decisions. *See id.*

Similarly, ERISA preempted another portion of the Act that mandated that managed care organizations could not enter into agreements with providers to obtain indemnification for any civil liability that the managed care organizations might suffer by being held liable under the Act's "quality of care" standards. *See id.* at 627. Another provision prevented a managed care organization from terminating a provider arrangement with any health care provider "for advocating on behalf of an enrollee for appropriate and medically necessary health care for the enrollee." *Id.* The court held that ERISA preempted both of these provisions because they bound ERISA administrators' choices in arranging the structure of ERISA plans. *See id.* In other words, they prevented administrators from structuring their plans in such a manner as to terminate providers and to obtain indemnification and hold harmless agreements from them; therefore, these provision had a impermissible connection with ERISA plans. *See id.*

217. Corporate Health Ins., Inc. v. Tex. Dep't of Ins., 215 F.3d. 526, 533 (5th Cir. 2000), *petition for cert. filed*, 69 U.S.L.W. 3317 (U.S. Oct. 29, 2000) (No. 00-665).

economic effects on the costs of health care plans, such as quality standards which vary from state to state."[218] Second, in response to managed care organizations' arguments that the application of the law would "relate to" ERISA plans because questions regarding the quality of care would "inevitably question the provider's determinations of coverage under an ERISA plan,"[219] the court asserted two reason why there should be no preemption of the "quality of care" provisions. First, the court interpreted the statute as being limited to claims challenging the quality of provided benefits, and not claims based upon a managed care organization's denial of benefits.[220] Second, the court recognized a distinction between a managed care organization's role as an administrator of an ERISA plan and its role as "an arranger and provider of medical treatment."[221] The court asserted that "ERISA preempts malpractice suits against doctors

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218. *Id.* at 533.

219. *Id.* at 534.

220. *See id.* The State of Oklahoma has adopted a statute that is very similar to Texas' Health Care Liability Act. *See* Managed Health Care Accountability Act ("MHCA"), OKLA. ST. ANN. tit. 36, § 6591 (West 2000). Section 6593 of MHCA provides:

> A health insurance carrier, health maintenance organization, or other managed care entity for a health care plan has the duty to exercise ordinary care when making health care treatment decisions and shall be liable for damages for harm to an enrollee proximately caused by breach of the duty to exercise ordinary care *if*:
>
> 1. The failure to exercise ordinary care resulted in the *denial, significant delay, or modification of the health care service recommended for, or furnished to, an enrollee*; and
>
> 2. The enrollee suffered harm.

Id. § 6593 (emphasis added). One can make an argument that there is a substantial possibility that ERISA will preempt this Oklahoma statue because, unlike Texas' Health Care Liability Act, the Oklahoma statute's duty of care provision imposes the duty of care requirement on a "denial, significant delay, or modification" of health benefits that are "recommended for, or furnished to, an enrollee." *Id.*

In other words, whereas the Texas law governs the quality of benefits that a patient actually receives, the Oklahoma statue governs a managed care organization's negligence in denying, delaying and modifying benefits. Therefore, the Oklahoma law probably "relates to" an ERISA plan, and therefore ERISA's preemption clause probably preempts it because it imposes a standard of care on a managed care organization's denial of benefits. Similarly, a state law claim under the statute would probably be completely preempted by section 502(a) of ERISA's civil enforcement provisions because such a claim appears to be legally cognizable under section 502(a). However, at least one court has held that an Illinois statute that imposes similar requirements as the Texas' statute's independent review provision (that the Fifth Circuit Court of Appeals, in *Corporate Health Insurance*, 215 F.3d at 526, found to be preempted) was saved from ERISA's preemption because the Illinois statue fell within ERISA's saving clause's exemption from ERISA's preemption. *See* Moran v. Rush Prudential HMO, Inc., 230 F.3d 959, 969 (7th Cir. 2000) (saved Illinois statute from ERISA preemption because it met both the "common sense understanding test" and saving Illinois statute "at least two of the McCarran-Ferguson factors").

221. *Corporate Health Ins.*, 216 F.3d at 534.

making coverage decisions in the administration of a plan, but it does not insulate physicians from accountability to their state licensing agency or association charged to enforce professional standards regarding medical decisions."[222] The court concluded that ERISA did not preempt a state's regulation of the quality of medicine when a managed care organization is acting as an arranger or provider of medical care.[223] In light of these observations, the court also held that Texas' "quality of care" statute did not "relate to" ERISA plans by "referring to" them since the provisions of the statute are "indifferent to whether the health care plan operates under ERISA and do not rely on the exercise of ERISA plans for their operation."[224]

The court also found that ERISA did not preempt the anti-indemnification[225] and anti-retaliation[226] provisions of the statute because, similar to the quality of care provisions, these provisions were a legitimate state regulation of the quality of medical care in that they preserved "the physician's independent judgment in the face of the managed care entity's incentives for cost containment."[227] In other words, these provisions were a legitimate part of the state's regulation of the quality of medical care that managed care organizations provide in their role as arrangers and providers of medical care.[228]

Similarly, the Fifth Circuit held that ERISA did not preempt the portion of the statute that required an independent review of claims that a plaintiff could bring under the "quality of care" portion of the Act because "[a]ny duty imposed on managed care entities by the independent review provisions extends no further than that imposed by the liability provision."[229] However, ERISA did preempt the portion of the Act that mandated an independent review of coverage denials in general (and not just of physicians' negligent treatment decisions) because it "impose[s] a state administrative regime governing coverage determinations."[230]

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222. *Id.* at 535.

223. *See id.*

224. *Id.*

225. This portion of Texas' law prevents managed care organizations from seeking indemnification from physicians in the event the organizations are held vicariously liable for the physicians' negligence.

226. This portion of Texas' law prevents managed care organizations from deselecting or refusing to contract with physicians who advocate treatment that is medically necessary.

227. *Id.* at 536. Regarding cost containment measures, the court stated: "Such a scheme is again[st] the kind of quality of care regulation that has been left to the states." *Id.*

228. *See id.* at 536.

229. *Id.* at 537-38.

230. *Id.* at 538. The court further held that ERISA's saving clause did not save the preempted independent review portion of the statue. Despite its meeting the "common sense" test and the McCarren-Ferguson three-factor analysis, that portion of the statute conflicted with ERISA's civil enforcement provision because it provided an alternative enforcement mechanism for obtaining ERISA benefits. *See id.* As such, the Fifth Circuit reasoned that the *Pilot Life* statements regarding the exclusivity of ERISA's civil enforcement provision warranted preemption of the independent review provision. *See id.* at 538-39. The independent review provision would have provided for

In sum, both the district court's decision and the Fifth Circuit's decision in *Corporate Health Insurance* establish that states can enact laws that regulate the quality of medical benefits that managed care organizations provide to employees under an ERISA plan without ERISA preempting such laws. These laws can even give injured beneficiaries a private state law cause of action for violations, and require an independent review of such claims before one can file a lawsuit based upon the violations. But, under the Fifth Circuit's opinion, a state law cannot provide for an independent review of a managed care organization's coverage denial decision when the organization has denied coverage during its role as an ERISA administrator of benefits.

Therefore, *Corporate Health Insurance* is an important decision that other states can use to substantially improve the quality of care that managed care organizations, and ultimately ERISA plans, give to health care beneficiaries. If other states follow Texas' lead by enacting statutes that control the standard of care that managed care organizations provide to beneficiaries, beneficiaries will have another level of needed protection against negligent medical treatment even when they obtain treatment under ERISA benefit plans.

E. Negligence in the Creation of Health Plans

Under certain situations, a managed care organization can be liable for medical malpractice because of the creation of a substandard health care plan. The relevant case law seems to make a distinction between health care plans that an ERISA plan itself establishes and health care plans that HMOs or other managed care organizations establish in carrying out their medical provider roles in conjunction with an ERISA plan. The reason for the difference is *Dukes*' distinction between a health plan's or managed care organization's role as an administrator of an ERISA plan and their role as an arranger or provider of medical care.[231]

As discussed below, ERISA will probably preempt state lawsuits challenging either an ERISA plan's or its managed care organization's decisions that fall within the administration of an ERISA plan, but will not preempt state law claims challenging at least a managed care organization's negligent medical decision that the organization or its agent makes during their role as arrangers or providers of medical care. *Moreno v. Health Partners Health Plan*[232] is instructive. In that case, the plaintiff alleged that she suffered injuries because a managed care organization created and maintained a substandard health care plan.[233] The court denied defendants' motion that ERISA preempted the state law medical

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an independent review of a managed care organization's coverage denial decisions, and mandated that the managed care organization accept the medical necessity determination of the independent reviewer. *See id.* at 538.

231. *See* Dukes v. U.S. Healthcare, Inc., 57 F.3d 350, 361 (1995).

232. 4 F. Supp. 2d 888 (D. Ariz. 1998).

233. *See id.* at 889.

malpractice claim.[234] In *Moreno*, the court stated:

> The allegations are nothing more nor less than recitations of traditional state law negligence claims. Each Defendant is alleged to be a *healthcare provider*. Each Defendant is alleged to have fallen below the applicable standard of care, either acting individually or through agents and employers. Each is alleged to have caused damage to the Plaintiff. Partners is alleged to be both directly liable for its own negligence (the creation of the substandard care plan by Aguilar) and vicariously liable for the negligence of the physicians who implemented that substandard care plan. Aguilar is alleged to be directly negligent for his role in creating the substandard plan.[235]

As did *Travelers*, the court bypassed the unhelpful text of "relate to" to "look instead to the objectives of ERISA" to determine whether ERISA preempted the state law claims.[236] The court relied on ERISA's general "beneficiaries protection" purpose but did not refer to the preemption clause purpose of avoiding a nonuniformity of ERISA plan regulation.[237] Then, the court analyzed defendants' preemption defense under several of *Travelers*' general purposes.[238]

First, the court outlined the three categories of state law that can be said to have a connection with ERISA plans: (1) "laws that mandate employee benefit structures or their administration," (2) "laws that bind employers or plan administrators to particular choices or preclude uniform administrative practice, thereby functioning as a regulation of an ERISA plan itself," and (3) "laws providing alternative enforcement mechanisms for employees to obtain ERISA plan benefits."[239] The court stated that the state malpractice claims did not satisfy any of the tests because

> the ability to sue on a medical malpractice claim does not mandate employee benefit structures or their administration, nor does it bind employers or plan administrators to particular choices or preclude uniform administrative practice, thereby functioning as a regulation of an ERISA plan itself, nor does it provide an alternative enforcement mechanism for employee to obtain ERISA plan benefits.[240]

The court reasoned that any tendency that a malpractice claim had to bind ERISA

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234. *See id.* at 892-93.

235. *Id.* at 889. First, the court distinguished both *Corcoran v. United Health Care, Inc.*, 965 F.2d 1321 (5th Cir. 1992), and *Spain v. Aetna Life Insurance Co.*, 11 F.3d 129 (9th Cir. 1993), two cases holding that medical malpractice wrongful death claims alleging negligence by those involved in denying requested medical treatment, as not being persuasive in light of *Travelers*' attempt "to narrow" the expansiveness of ERISA's preemption clause. *See id.* at 891.

236. *Moreno*, 4 F. Supp. 2d at 891.

237. *See id.*

238. *See id.* at 891-92.

239. *Id.*

240. *Id.* at 892.

plans "to making choices that were not willfully or recklessly injurious" were "evaluative and not particular," and Congress has expressed no desire that ERISA be used to degrade the quality of healthcare."[241]

Second, the court acknowledged the presumption that ERISA did not intend to preempt "the historic police powers of States,"[242] which "include the regulation of matters of health and safety."[243] Importantly, the court stated that "[N]othing in the language of [ERISA] or the context of its passage indicates Congress chose to displace general health care regulation."[244] The court hung its hat on *Dukes*' distinction between state law claims premised on the "quality of care" versus claims based on the "quantity of benefits."[245] The court held that "plaintiff's malpractice claim goes to the quality of care received."[246] Because of these reasons, ERISA did not preempt the malpractice claims.

The court further relied on the Ninth Circuit's mode of analysis of ERISA's preemption clause: "[W]here state law claims fall outside the three areas of concern identified in *Travelers*, arise from state laws of general application, do not depend on ERISA, and do not affect the relationships between the principal ERISA participants; the state law claims are not preempted."[247] Applying the Ninth Circuit's test, the court stated:

> Continuing with the analysis of the Ninth Circuit in *Geweke*, medical malpractice actions are grounded in state common law of general application to any practitioner of medicine whether or not arranged, paid for, or employed by an employer provided benefit plan. The possibility of medical malpractice actions do not affect the relationships between the principal ERISA participants.
>
> Under the analysis adopted by the Ninth Circuit, medical malpractice actions are not preempted. This is reinforced by the Supreme Court

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241. *Id.* at 893.

242. *Id.* at 892.

243. *Id.* (quoting N.Y. State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co., 514 U.S. 645, 661 (1995)).

244. *Id.* The court stated:

> In addition, myriad state laws of general applicability may impose some burdens on the administration of ERISA plans and still not "relate to" them within the meaning of the ERISA statute. The Supreme Court gives the example of quality standards in a hospital which would effect the relative costs of a plan.

Id. at 892. (citing *Travelers*, 514 U.S. at 660 (internal citations omitted)).

245. *Id.*

246. *Id.*

247. *Id.* (citing Geweke Ford v. St. Joseph's Omni Preferred Care Inc., 130 F.3d 1355, 1360 (9th Cir.1997) (quoting Ariz. State Carpenters Pension Trust Fund v. Citibank, 125 F.3d 715 (9th Cir.1997)).

> referring to the general regulation of health and safety as examples of historic powers of the State which have not been superceded by Federal Act.[248]

In sum, the court found that ERISA did not preempt the state law medical malpractice claims under either *Dukes*' rationale or under the Ninth Circuit's formula.[249] Although the court's decision involved a defendant's alleged negligence in the manner in which it created a health plan, the court's reference to *Travelers*' statement, that "the general regulation of health and safety [is an] example of historic powers of the State which have not been superceded by [ERISA]," is evidence that the *Moreno* court would not have found a preemption of other types of state lawsuits challenging the quality of care of provided medical benefits.

There is uncertainty about the scope of the *Moreno* decision as it relates to managed care organizations' and ERISA plans' ability to create substandard health plans. As stated above, the decision hinges on the distinction between a managed care organization's action as an arranger or provider of medical benefits and not as an administrator of benefits. When the organization is acting as an arranger or provider, one can make a strong argument that ERISA does not preempt state law medical malpractice claims alleging that the organization has created a substandard health plan. As the court stated in *Moreno,* such claims are "grounded in state common law of general application" and fall within *Travelers*' admonition that there is no evidence that Congress intended to preempt states' historic police power regulation of health and safety.[250]

On the other hand, when the state lawsuit challenges a managed care organization's decision to create a substandard health plan in its ERISA plan administration role, one can make a stronger argument that the lawsuit falls within Supreme Court precedent that arguably mandates preemption when a state law or lawsuit attempts to limit the manner in which an ERISA plan structures its operations.[251] One could allege that *Shaw* is applicable and that, like the New York law that prevented ERISA plans from structuring their operations to discriminate against pregnant women,[252] a state lawsuit that prevents an ERISA plan from structuring itself in a way to provide substandard care also impermissibly impinges on the plan's ability to structure its operations in a desired manner. This is especially true because ERISA does not specifically regulate the quality of benefits that an ERISA plan actually gives to beneficiaries

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248. *Id.* at 893.

249. *See id.* at 892. Although *Moreno* is a complete preemption case, its statements about the nonpreemption of state medical malpractice lawsuits is relevant to a conflict preemption analysis under ERISA's preemption clause. The court left open the issue whether the defendants were practicing medicine for medical malpractice purposes and whether any malpractice was the proximate cause of plaintiff's injury. *See id.* at 893.

250. *Id.*

251. *See, e.g.*, Shaw v. Delta Air Lines, Inc., 463 U.S. 85 (1983).

252. *See id.* at 97.

as opposed to the plan's decision to deny benefits.[253] The only rebuttal against preemption under *Shaw*'s rationale is the applicability of several influential principles from *Travelers*.

First, *Travelers* appears to be a refinement of *Shaw*'s "too tenuous, remote, or peripheral" exception to preemption. It stands for the proposition that ERISA will not preempt a state law that has a "too tenuous, remote, or peripheral" impact on an ERISA plan, even though the law affects the ability of a managed care organization to structure its benefits.[254] Second, *Travelers*' presumption against the preemption of state health care regulations (which encompasses state medical malpractice claims) and *Travelers*' assumption, that a state law that imposes only indirect economic cost on an ERISA plan is not sufficient to warrant preemption, can be used to argue against preemption despite the main holding in *Shaw* regarding the interference with an ERISA plan's ability to structure its operation. In other words, *Shaw* does not appear to have taken into consideration the implication of *Travelers*' presumption against the preemption of traditional state law regulation.

A review of three cases illustrates the confusion that courts can have in resolving preemption issues by using a distinction between a managed care organization's ERISA plan administrative role and the organization's medical provider role. The Third Circuit's[255] decision in *In re U.S. Healthcare, Inc.*,[256] the court's first case to consider its earlier decision in *Dukes*, reaffirms its belief that there is a difference between a managed care organization's decisions as an administrator of an ERISA plan and its decisions as an arranger or provider of medical care. The court held that the plaintiff's state law claims for direct liability and vicarious liability, alleging that an HMO had committed medical malpractice when it instituted a policy of discharging mothers twenty-four hours after their deliveries, did not fall within the complete preemption doctrine for removal from state court to federal court.[257] Although the court did not decide the substantive issue of whether ERISA preempted the state law claims, the court's complete preemption analysis is instructive.

The gist of the court's opinion is that the plaintiff's state law claims alleged negligence against the HMO and its agents in their role as providers of medical care.[258] For example, the plaintiff alleged that the HMO, the treating physician, and the hospital committed medical malpractice by discharging the mother under the twenty-four hour policy.[259] The court held that such allegations attacked the

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253. *See* Robert F. Rich & William D. White, *Federalism and Health Care Policy*, 1998 U. ILL. L. REV. 861, 875.

254. N.Y. State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co., 514 U.S. 645, 646 (1995).

255. The Third Circuit has been one of, if not the, most proactive courts in developing new principles and analysis to determine the scope of ERISA's preemption of state law.

256. 193 F.3d 151 (3rd Cir. 1999).

257. *See id.* at 165.

258. *See id.* at 162-63.

259. *See id.*

quality of the medical care that the defendants provided, not negligence during the HMO's ERISA administrative role of denying or granting a beneficiary's request for medical benefits.[260] Therefore, pursuant to *Dukes*' reasoning that

260. *See id.* In *Lazorko v. Pennsylvania Hospital*, 237 F.3d 242 (3rd Cir. 2000), the Third Circuit affirmed its conclusion that ERISA does not completely preempt a direct state law claim against an HMO or other managed care organizations whose financial incentives allegedly motivated a treating physician to render negligent medical care to obtain the financial benefits. *See id.* at 249-50. After wife committed suicide allegedly because treating physician did not order additional hospitalization, plaintiff alleged that treating physician, motivated by an HMO's financial incentives that penalized a decision to grant additional hospitalizations, made the medical decision not to readmit her to the hospital. *See id.* Importantly, the claim against the HMO appears to be a direct liability claim because it attacked the HMO's financial incentives on the grounds that they negligently motivate the treating physician to render negligent medical care. *See id.* Apparently, the Third Circuit's decision was based upon a conclusion that the state lawsuit challenged the quality of the HMO's medical decision to institute financial incentives that motivated treating physicians to give substandard medical care, and not a specific decision by an HMO to deny medical benefits. *See id.* Therefore, ERISA's civil enforcement provisions did not completely preempt the claims. *See id* at 250.

Other courts have reached a similar conclusion that state lawsuits complaining about an HMO financial incentives are not preempted. *See* Berger v. Livengrin Found., No. 00-CV-501, 2000 WL 325957, *3 (E.D. Pa. Mar. 27, 2000) ("The Court reads the Complaint's allegations regarding USHC's disincentive policy as challenging the quality of medical care provided."); Stewart v. Berry Family Health Ctr., 105 F. Supp. 2d 807, 815 (S.D. Ohio 2000) (denying complete preemption because plaintiff alleged that "financial incentive program impacted the quality of care that she received from her physicians"); Green v. Travis, No. 00-C-2230, 2000 WL 1409828, *2 (N.D. Ill. July 21, 2000) (denying complete preemption, in part, by rejecting defendant's claim that plaintiffs' reliance on "'financial disincentives' imposed by [defendant] on its providers makes their claim one which arises under ERISA §502(a)); Delucia v. St. Luke's Hosp., No. 98-6446, 1999 WL 387211, *4 (E.D. Pa. May 24, 1999) (denying complete preemption where plaintiff's complaint alleged that "Aetna's disincentive policy had the effect of discouraging doctors from 'provid[ing] complete and proper care . . .," because the claim "challeng[ed] the quality of medical care provided."); Hinterlong v. Baldwin, 720 N.E.2d 315, 325 (Ill. 1999) (denying defendant's contention that ERISA's preemption clause preempted plaintiff's vicarious liability claim against HMO even though the claim alleged that the HMO's financial incentives encouraged the treating physicians to render negligent medical care, thereby rejecting an argument that the claim was tantamount to one alleging "elements of a denial of benefits").

However, some courts might be influenced by whether the ERISA plan's documentation itself set forth the financial incentives, or whether the HMO's contract with affiliated treating physicians establishes the financial incentives. The inference is that, in the former situation, section 502(a) might completely preempt the state law claim for removal purposes, but that it will not do so in the latter situation because, unlike in the former situation, the latter situation does not require an examination of the ERISA plan to ascertain the nature, scope, and potential effects of the financial incentives. This avoids a potential conclusion that, if the incentives are set out in the ERISA plan itself, the litigation of the vicarious liability claim would require a "reference to" the ERISA plan which would satisfy the "relate to" requirement and cause ERISA's preemption. *See Green*, 2000

state claims challenging the quality of provided benefits do not fall within the complete preemption doctrine and to the distinction between a managed care organization's role as a medical provider and as an administrator who decides whether to grant or deny benefits, the court in *In re U.S. Healthcare* held that plaintiff's state law claims were not removal under the complete preemption doctrine.[261]

However, given the dual role that managed care organizations play in providing medical care to beneficiaries under ERISA benefit plans, the court recognized that it would not always be easy to determine the exact role that a managed care organization was playing at the time of its alleged negligent conduct.[262] For example, in *In re U.S. Healthcare*, the court held that ERISA did not completely preempt the sixth count of the plaintiff's complaint. That count alleged that U.S. Healthcare was negligent because it did not provide plaintiff with a pediatric nurse even though the ERISA plan covered such treatment and plaintiff requested the treatment.[263] Despite the district court's holding that plaintiff's claim was tantamount to a claim for denied benefits, the Third Circuit held that the count "raise[d] a claim regarding the adequacy of the care that [plaintiff] received and was therefore directed toward the HMO's action in its capacity as a medical provider, rather than as a benefits administrator."[264] The Third Circuit asserted that plaintiff's allegation could be interpreted as alleging that "U.S. Healthcare failed to meet the standard of care required of health care providers by failing to arrange for a pediatric nurse," and therefore was "an ordinary state-law tort claim for medical malpractice."[265]

In contrast, the court in *Lancaster*[266] would not rely on the medical provider versus ERISA administrator distinction to hold that a managed care organization's structuring of its utilization review and cost containment procedures occurred during the managed care organization's provider role. In *Lancaster,* a child suffered an alleged misdiagnosis of a brain tumor despite the

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WL 1409828 at *2-*3. In other words, complete preemption for removal purposes, and maybe conflict or substantive preemption, would occur because resolution of the state law claim would require an "interpretation of the ERISA plan." *See id.* However, the mere "reference to" the plan during the lawsuit might fall within the "too tenuous, remote, or peripheral" exception to ERISA's preemption, which would not lead to preemption if the claim is based upon vicarious liability for the treating physician's alleged negligent treatment and not upon a denial of a specific request for medical benefits. *Hinterlong*, 720 N.E.2d at 325 (rejecting alleging that preemption should occur because of a "reference to" an ERISA plan to evaluate the financial incentives, asserting that "any reference to the plan documents would be necessary only for proving matters of agency, not for wrongful plan administration or for withholding of promised plan benefits").

261. *In re U.S. Healthcare*, 195 F. 3d at 162-63.

262. *See id.* at 162.

263. *See id.* at 164.

264. *Id.*

265. *Id.*

266. *See generally* Lancaster v. Kaiser Found. Health Plan of Mid-Atl. States, Inc., 958 F. Supp. 1137 (E.D. Va. 1997).

fact that she had sought treatments from the same physicians over a four and a half year period with complaints of intense headaches and other symptoms.[267] Eventually, the treating physicians ordered an MRI that showed that a tumor had infected approximately forty percent of the child's brain.[268] In part, the plaintiff's state medical malpractice lawsuit alleged both direct liability and vicarious liability claims against Kaiser, the HMO involved in the arrangement of plaintiff's medical care under an ERISA plan.[269] In Count III against Kaiser, plaintiff alleged that Kaiser

> is directly liable for the establishment of guidelines and cost standards which worked against the full and prompt diagnostic assessment [of Lancaster's brain tumor] within the accepted standard of care and for its failure to establish policies, protocols, guidelines and standards for an adequate diagnostic assessment and treatment of [Lancaster's] continuing headaches.[270]

In Count V against Kaiser, the plaintiff alleged that Kaiser committed fraud when it told plaintiff that it would follow the applicable standard of medical care in providing for her treatment but instead instituted a financial incentive policy that provided a financial benefit to the treating physicians for not providing care in compliance with the standard of medical care.[271]

Count IV, against the treating physicians' medical group, alleged that the group

> is further negligent for the establishment of guidelines and cost standards which work[ed] against [Lancaster] receiving a proper diagnosis and treatment assessment within the standard of care during the course of her treatment for her headaches and for the failure to establish policies, protocols, guidelines and standards for her diagnostic assessment during her hospitalization.[272]

Count V against the medical group contained the same allegations of fraud as stated above against Kaiser.[273]

The court held that, under the complete preemption doctrine, the second section of Counts III and V against Kaiser, as discussed above, served as grounds for removal to federal court because they challenged the administration of the ERISA plan to the extent that they "focus[ed] on Kaiser's administrative decision to curb rising health care costs by employing a system of financial incentives that rewarded physicians for not ordering tests or treatments."[274] The court further

267. *See id.* at 1139-40.
268. *See id.* at 1140.
269. *See id.* at 1140-41.
270. *Id.* at 1141.
271. *See id.*
272. *Id.*
273. *See id.*
274. *Id.* at 1147.

reasoned that the plaintiff's claims against Kaiser in effect alleged that the managed care organizations' financial incentives "had the effect of denying benefits to Lancaster as a plan participant because it inappropriately influenced" the treating physicians to take their own financial well-being into consideration in making decisions regarding the plaintiff's treatment.[275] As such, the court held that the claims fell within section 502(a)(1)(B) of ERISA's civil enforcement provisions, thereby requiring complete preemption of the whole lawsuit, including Count IV and Count V against the medical group.[276]

The court proceeded to find that ERISA preempted the Count III and Count V claims against Kaiser. The court reasoned that the claims were preempted by ERISA's preemption clause, apparently because the claims, as reclassified by the court to be ones for denied benefits, "relate[d] to" the ERISA plan.[277] Similarly, the court held that ERISA also preempted Counts IV and V against the medical group because "[l]ike the direct negligence and fraud claims against Kaiser, the direct negligence and fraud claims at issue here, at their core, assert that Lancaster was denied benefits by the administrative decision to establish and implement the Incentive Program, a policy that encouraged [the treating physicians] to limit health care costs."[278] The court thought that a decision against preemption would create disuniformity in the regulation of ERISA plans. In addition, the court felt that there would be no claim against the medical group if there was no ERISA plan because "the terms and conditions of the plan are a critical factor in establishing defendants' liability under [the] claims."[279]

On the other hand, at least one court, consistent with *In re U.S. Healthcare* and in opposition to *Lancaster*, is more willing to hold that ERISA does not preempt an HMO's cost containment procedures when a plaintiff alleges that the procedures caused low quality medical treatment. In *Maltz v. Aetna Health Plans of New York, Inc.*,[280] the Second Circuit considered whether an HMO's decision to change it preferred providers' compensation arrangement from fee-for-service to a capitation arrangement was in violation of ERISA's substantive provisions.[281] The plaintiff, who had chosen a primary care physician from the preferred provider list to treat her children, alleged that a capitated payment arrangement denied her family "reasonable and medically necessary" services."[282] However, the court found the allegation to be without merit.[283] Relying on *Travelers* and *Dukes*, the court stated that "*Maltz* is essentially alleging a reduction in the quality of care that is properly brought under state law

275. *Id.*

276. *See id.* at 1147-48.

277. *Id.* at 1150.

278. *Id.* The court did not state whether the claims against the medical group were independently removable under the complete preemption doctrine.

279. *Id.*

280. No. 97-7942, 1998 WL 385830 (2d Cir. Apr. 20, 1998).

281. *See id.* at *1.

282. *Id.*

283. *See id.*

and is not preempted by ERISA."[284] In essence, the Second Circuit's decision in *Maltz* is consistent with an interpretation of *Travelers* as being precedent that ERISA does not preempt lawsuits, such as medical malpractice lawsuits, alleging that a managed care organization provided substandard benefits.[285]

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284. *Id.* at *2 (citing N.Y. State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co., 514 U.S. 645 (1995); Dukes v. U.S. Healthcare, Inc., 57 F.3d 350 (1995)).

285. *See Maltz*, 1999 WL 385830, at *2. It is important to note that in *Maltz* there was no complaint that the health plan had denied requested benefits; rather, plaintiff had access to any physician that her family needed under the health plan. Her only complaint was that the quality of the care from a chosen physician either was or might be comprised and of a lower quality because of the capitation payment agreement. *See id.* at *1. Other Second Circuit cases are consistent with a expansive interpretation of *Travelers* that narrowly interprets ERISA's preemption clause.

For instance, in *Devlin v. Transportation Communication International Union*, 173 F.3d 94 (1st Cir. 1999), the Second Circuit was asked to consider whether ERISA preempted the same New York human right law as at issue in *Shaw v. Delta Air Lines, Inc.*, 463 U.S. 85, 96-100 (1995). *Devlin*, 173 F.3d at 99. Although the court acknowledged that *Travelers* "narrowed the parameters for determining when a state statute 'relates to' an ERISA plan," it declined to reevaluate whether ERISA preempted the human rights law given that *Shaw*, a decision before *Travelers* that specifically addressed the same preemption issue, had held that the law was preempted. *Id.* The court's refusal to reevaluate the preemption issue was based on its unwillingness to create a direct conflict with *Shaw*, a United States Supreme Court decision on the precise issue.

However, despite recognizing that *Travelers* has changed the focus of ERISA's preemption analysis, the Second Circuit acknowledged that the text of a disputed statute is still the starting point of an ERISA analysis. *See* Foxhall Realty Law Offices, Inc., v. Telecomm. Premium Servs., Ltd., 156 F.3d 432. 435 (2nd Cir. 1998) ("In determining whether Congress intended to confer federal jurisdiction over private rights of action brought under the TCPA, our 'analysis begins with the text of the provision in question.'") (citing *Travelers*, 514 U.S. 645, 655 (1995)). Recognizing *Travelers*'s impact on an ERISA's preemption clause analysis, the Second Circuit, in *Plumbing Industry Board, Plumbing Local Union No. 1 v. Howell Co.*, 126 F.3d 61 (2d Cir. 1997), outlined its steps in analyzing an ERISA preemption defense including the use of the presumption against the preemption of state laws:

> In other words, the phrase "relate to" for purposes of legal analysis proved to be a verbal coat of too many colors. Instead, the Supreme Court has instructed that analysis under ERISA's preemption clause must begin with the "starting presumption that Congress does not intend to supplant state law," and admonished courts applying the preemption clause to "look to the objectives of the ERISA statute as a guide to the scope of the state law that Congress understood would survive." That look should be guided by common sense. It should avoid a construction that theoretically is unending, which the Supreme Court warned against when it turned away from "relate to" as a guide. Hence, to overcome the anti-preemption presumption, a party challenging a statute must convince a court that there is something in the practical operation of the challenged statute to indicate that it is the type of law that Congress specifically aimed to have ERISA supersede. The Supreme Court has identified several ways in which the anti-preemption presumption can be overcome. First, preemption will apply where a state law clearly "refers to" ERISA plans in the sense that the measure "acts immediately and exclusively

In comparison, *Maltz* is in conflict with *Lancaster* because, although in both cases the plaintiff complained about a cost containment method that allegedly led to low quality health care, the courts reached different conclusions on whether ERISA preempted the plaintiff's state law claims. The fact that in *Lancaster* the plaintiff's complaint was about financial incentive systems that gave treating physicians bonuses for "avoiding excessive treatments and tests," and in *Maltz* the plaintiff's complaint was about a capitated payment system,[286] is irrelevant to the extent that both systems allegedly led (or had the potential of leading) to less care than required by the applicable standard of care. Given this conflict, the status of state law attempts to prevent managed care organizations and ERISA plans from establishing low quality plans is unclear. Following *In re U.S. Healthcare* and *Maltz*, some courts will not find preemption, while others will find preemption pursuant to *Lancaster*'s rationale.

VI. THE FUTURE OF ERISA'S PREEMPTION

The above discussion shows that, following *Travelers*' lead, federal courts have limited ERISA's preemption of state law medical malpractice claims. Primarily, these courts have used the presumption against the preemption of traditional state health care regulations and the indirect economic effects of state

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> upon ERISA plans" or where "the existence of ERISA plans is essential to the law's operation." Second, a state law is preempted even though it does not refer to ERISA or ERISA plans if it has a clear "connection with" a plan in the sense that it "mandate[s] employee benefit structures or their administration" or "provid[es] alternative enforcement mechanisms." Outside these areas, the presumption against preemption is considerable—state laws of general application that merely impose some burdens on the administration of ERISA plans but are not "so acute" as to force an ERISA plan to adopt certain coverage or to restrict its choice of insurers should not be disturbed.

Id. at 66-67 (internal citations omitted). The above quote from the Second Circuit is one of the clearest statements regarding how courts should analyze a state law under the presumption against the preemption of state laws.

In the Second Circuit, to avoid preemption a state law must not interfere with ERISA's preemption clause purpose of "avoid[ing] a multiplicity of regulation in order to permit the nationally uniform administration of employee benefit plans." Greenblatt v. Delta Plumbing & Heating Corp., 68 F.3d 561, 574 (2d Cir. 1995). Such interference occurs when the state laws "mandate[ ] employee benefit structures or their administration" or "provid[e] alternate enforcement mechanisms" to section 502(a). *Id.*

In *Demars v. CIGNA Corp.*, 173 F.3d 443, 446 (1st Cir. 1999), the court stated that "cost uniformity was almost certainly not an object of [ERISA] pre-emption." ERISA preemption was intended to guarantee regulatory uniformity, not intrastate or interstate cost uniformity. *Demars*, 173 F.3d at 446. *Demars*' distinction between regulatory uniformity and cost uniformity is important, and it should serve as a guide to other courts that interpret ERISA's preemption clause.

286. *See* Lancaster v. Kaiser Found. Health Plan of Mid-Atl. States, Inc., 958 F. Supp. 1137, 1140 (E.D. Va. 1997); *see also supra* notes 281-82 and accompanying text.

medical malpractice lawsuits as their rationales.[287] Using these rationales, some courts have held that ERISA does not preempt a direct liability medical malpractice claim against a treating physician because of states' traditional authority to regulate the quality of medical care.[288] Other courts have held that ERISA does not preempt a state law vicarious liability claim against a managed care organization that has supplied a negligent treating physician because the claim involves the quality of medical care and is not a claim for denied medical benefits.[289] Therefore, a direct liability claim against the treating physician and a vicarious liability claim against an HMO or other medical provider of the treating physician are the state law claims that are most likely to escape ERISA's preemption. Additionally, some courts are now more willing to hold that ERISA does not preempt direct liability claims against managed care organizations based upon their failure to comply with state statutes that establish the applicable quality of medical care and direct liability claims based upon negligent medical decisions that the managed care organizations themselves make.[290]

On the other hand, the most problematic claims are those that challenge an ERISA administrator's decisions during the utilization review process of deciding whether or not to award benefits. These claims fall into several categories. First, some courts hold that ERISA preempts a state law claim alleging that the ERISA administrator or other fiduciary made a negligent medical decision during utilization review, while other courts find the opposite.[291] Second, some courts hold that ERISA preempts state law claims challenging an ERISA plan's and its affiliated providers' financial incentives and other policies and procedures designed to control the cost of medical care, while other courts imply that ERISA does not preempt such claims.[292] These types of state law claims are more problematic than claims alleging either direct medical malpractice against a treating physician or vicarious liability against an HMO or other managed care organizations. The reason is that one can make an argument that such claims fall within *Pilot Life*'s holding that ERISA preempts claims alleging an improper processing of a request for ERISA plan benefits during the utilization review process.

Therefore, given the continued validity of *Pilot Life*, there is a possibility that ERISA will continue to preempt a large number of medical malpractice lawsuits when the challenged medical decisions occur during an ERISA administrator's or managed care organization's utilization review process of granting or denying

287. *See Lancaster*, 958 F. Supp. at 1149.

288. *See id.*

289. *See* Dykema v. King, 959 F. Supp. 736 (D. S.C. 1997).

290. *See* Corporate Health Ins. v. Tex. Dep't of Ins., 215 F.3d 526 (5th Cir. 2000); Crum v. Health Alliance-Midwest, Inc., 47 F. Supp. 2d 1013 (C.D. Ill. 1999).

291. *See Crum*, 47 F. Supp. 2d at 1013; Andrews-Clarke v. Travelers Ins. Co., 984 F. Supp. 49 (D. Mass. 1997).

292. *See* Maltz v. Aetna Health Plans of N.Y., Inc., No. 97-7942, 1998 WL 385830 (2d Cir. Apr. 20, 1998); *Lancaster*, 958 F. Supp. at 1150.

treatment.[293] To avoid this result, federal courts should turn to their equity jurisdiction to prevent the injustice that results when ERISA plan administrators' and managed care organizations' negligent decisions go unpunished because there is not an adequate remedy to compensate beneficiaries for their injuries. The following sections of this Article proposes that federal courts use "equity preemption"[294] to provide an otherwise unavailable remedy to negligently injured beneficiaries.

A. Equity Preemption

It is fairly clear that Congress intended that the law of trust govern ERISA welfare benefit plans.[295] This observation leads to two conclusions. First, as the law of trust is within federal courts' equity jurisdiction,[296] federal courts should use equity principles when interpreting ERISA's preemption clause, especially given their inherent and statutory equity power to interpret ERISA's statutory provisions.[297] Court's equity analysis should include one of the well-established maxims of equity: "Equity will not suffer a wrong without a remedy." This Article will subsequently refer to the use of equity principles and maxims as

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293. *See Andrews-Clarke*, 984 F. Supp. at 54 n.23 (holding that ERISA preempted state claim because alleged negligent decision occurred during the utilization review process of deciding whether or not to provide medical treatment).

294. *See infra* notes 295-378.

295. *See* Hughes Aircraft Co. v. Jacobson, 525 U.S. 432, 447 (1999) ("Although trust law may offer a 'starting point' for analysis in some situations, it must give way if it is inconsistent with 'the language of the statute, its structure, or its purposes.'"). In *Mertens v. Hewitt Associates*, 508 U.S. 248 (1993), the Supreme Court stated:

> Given ERISA's roots in the law of trusts, "equitable relief" could in theory mean all relief available for breach of trust in the common-law courts of equity, which would include the relief sought here. Since all relief available for breach of trust could be obtained from an equity court, however, that interpretation would render the modifier "equitable" superfluous; that reading would also deprive of all meaning the distinction Congress drew between "equitable relief" and "remedial" and "legal" relief throughout ERISA.

Mertens, 508 U.S. at 248-49. The Court also stated: "It is true that, at common law, the courts of equity had exclusive jurisdiction over virtually all actions by beneficiaries for breach of trust." *Id.* at 256. The Court asserted: "Finally, there can be no dispute that ERISA was grounded in this common-law experience and that we are [to be] guided by principles of trust law in construing the terms of the statute." *Id.* (White, J., dissenting) (citing Firestone Tire & Rubber Co. v. Bruch, 489 U.S. 101, 111 (1989)). *See also* Anthony v. Texaco, Inc., 803 F.2d 593, 599 (10th Cir. 1986) ("Accordingly, we hold that the district court did not err in exercising its equitable jurisdiction under ERISA to freeze the assets owing to the defendant corporations.").

296. *See supra* note 295 and accompanying text.

297. *See* Cummings v. Briggs & Stratton Ret. Plan, 797 F.2d 383, 390 (7th Cir. 1986) (refusing to create a claim for unjust enrichment, but asserting that federal courts have both inherent and statutory equitable power to interpret and enforce ERISA).

"equity preemption."[298]

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298. In a nutshell, equity preemption means that courts will use their equity jurisdiction and powers to ensure that ERISA will not preempt state law claims when ERISA does not supply a remedy, especially in those areas where congressional intent regarding ERISA's preemption of state law claims is not clearly expressed in either ERISA's statutory language or legislative history. Both federal and state courts can use the "equity preemption" concept. A state court can use it when a plaintiff has filed a state law claim in state court, and the defendant has not removed the claim to federal court. In that event, the state court will have to resolve any ERISA preemption defense that the defendant raises. A federal court can use "equity preemption" in those cases that a plaintiff either initially files in federal court or in the cases that a plaintiff files in state court and a defendant removes to federal court under the complete preemption doctrine. In those cases, the defendant, at some point, might raise an ERISA preemption defense. Whether a defendant raises the defense in federal or state court, "equity preemption" should become a part of the federal common law of ERISA preemption that should be obligatory on both federal and state courts as is the Black Law Dictionary's definition of "relate to." There are several factors that weigh in favor of courts' use of "equity preemption." First, as it relates to federal courts, they have both statutory and inherent powers to use equity principles when interpreting ERISA and ERISA's preemption clause. *See supra* notes 294-97 and accompanying text.

Second, Congress, as indicated in ERISA's legislative history, intended that federal courts (and state courts to the extent that they have an opportunity to interpret ERISA's preemption clause) develop a federal substantive common law of ERISA remedies and doctrines to fill gaps that ERISA's statutory provisions do not cover. *See* Pittman, *supra* note 22, at 436-40 (in part citing Senator Javits' legislative history statement regarding courts' abilities to create federal substantive common law and the Supreme Court's inconsistent use of his statement). At a minimum, the scope of a courts' powers to create federal substantive common law should include the use of "equity preemption," which, in one sense, is tantamount to a rule of statutory interpretation that gives courts guidance on how they should resolve issues involving the application of ERISA's preemption to state laws.

In other words, courts' use of "equity preemption" becomes a part of ERISA's federal substantive common law, and therefore is a legitimate use of courts' powers as recognized by ERISA's legislative history and by the Supreme Court, which has acknowledged courts' authority to create federal substantive common law when interpreting ERISA and its preemption clause. The only open issue is whether the use of "equity preemption" falls within courts' powers to create a federal common law surrounding ERISA and its preemption clause. There are at least two responses to this issue. One, to the extent that the Supreme Court has the authority to define "relate to," to create the "too tenuous, remote, or peripheral" exception to ERISA preemption, to create the presumption against the preemption of state laws in traditional areas of states' regulation, and to hold in *Travelers* that an indirect economic effect on an ERISA plan was not sufficient to warrant preemption, the use of "equity preemption" to avoid the preemption of state laws seems more than appropriate when there is no clear and manifest showing that Congress intended the preemption of a challenged state law. In such cases, "equity preemption" promotes the presumption against the preemption of traditional laws, and is therefore a proper recognition of federalism especially when the challenged state law is one that regulates the quality of medical care, a field that traditionally has fallen within states' legitimate police power regulation.

Third the use of "equity preemption" to avoid the preemption of state laws seems no more

drastic than the Supreme Court's use of equity principles to create federal causes of action from certain provisions of the United State Constitution. For example, in *Bivens v. Six Unknown Named Agents*, 403 U.S. 388 (1971), the Court held that an injured party can bring a private cause of action directly under the Fourth Amendment for compensatory damages stemming from a federal law enforcement agent's violation of the party's Fourth Amendments rights, even though the Amendment's language does not specifically provides for a compensatory damage remedy. *See Bivens*, 403 U.S. at 397. The Court stated: "Historically, damages have been regarded as the ordinary remedy for an invasion of personal interests in liberty. . . . 'The very essence of civil liberty certainly consists in the right of every individual to claim the protection of the laws, whenever he receives an injury.'" *Id.* at 395-97 (quoting Marbury v. Madison, 5 U.S. (1 Cranch) 137, 163 (1803)). If the Supreme Court can create a personal injury claim under the Fourth Amendment, because "the very essence of civil liberty" is that there should not be a wrong without a remedy, then certainly, through "equity preemption," courts (especially to effectuate the presumption against the preemption of states' traditional policy power protection of injured citizens) should be able to deny ERISA preemption of state law and lawsuits that remedy violations of independent state law obligations, especially when there is no clear and manifest showing of Congressional intent that preemption should occur.

Fourth, the use of "equity preemption" does not appear to be more drastic than state courts' use of equity principles to allow state law causes of actions and remedies for injuries that state citizens have suffered. For example, in a 1994 lawsuit, attorneys in Mississippi filed an equity restitution claim against tobacco manufactures alleging that they were unjustly enriched through the substantial profits that they made from selling cigarettes in Mississippi without paying the medical expenses stemming from the injuries that the cigarettes caused. *See* Doug Rendleman, *Common Law Restitution in the Mississippi Tobacco Settlement: Did the Smoke Get in Their Eyes?*, 38 GA. L. REV. 847, 848 (1999). The plaintiffs' attorneys and the tobacco defendants reached a settlement for $3.3 billion. *See id.* The relevancy of the Mississippi tobacco litigation to this Article is that it shows a state court's acceptance of an equity cause of action to provide a remedy primarily by using the equity maxim that "equity will not suffer a wrong without a remedy." *See id.* at 865 ("'The State seems to have sued in Chancery for two reasons. The first was to claim a maxim of equity. [] Equity will not suffer a wrong without a remedy. . . . This Honorable Court of equity should intervene and fashion a remedy to right this wrong.'"). Similarly, courts should accept "equity preemption" as a means of avoiding the preemption of state law claims vindicating violations of independent state law obligations by providing a compensatory damage remedy.

Finally, one can make an analogy to Rule 19 of the Federal Rules of Civil Procedure. That rule, particularly its indispensable party standards in Rule 19(b), has its origins in the maxim that "equity will not suffer a wrong without a remedy" and the court cases using that maxim to join necessary parties, against their will, to lawsuits if their presences were needed so that parties to the lawsuits could obtain a remedy or otherwise avoid any prejudice or inconsistent obligations flowing from the absence of necessary parties. *See* Indep. Wireless Tele. Co., v. Radio Corp. of Am., 269 U.S. 459, 472 (1926) (asserting that "if there is no other way of securing justice to the exclusive licensee, the latter may make the owner without the jurisdiction a coplaintiff without his consent in the bill against the infringer. Equity will not suffer a wrong without a remedy") (citing 1 POMEROY'S EQUITY JURISPRUDENCE §§ 423, 424). *See generally* Geoffrey C. Hazard, Jr, *Indispensable Party: The Historical Origin of a Procedural Phantom*, 61 COLUM. L. REV. 1254 (1961) (discussing the equity origins of Rule 19). Importantly, Rule 19(b) mandates that a federal

B. First Step of an Equity Preemption Analysis

In applying "equity preemption," a federal court does not have to engage in wholesale judicial lawmaking, but can continue to rely on *Travelers'* principles that narrows ERISA's preemption. Courts can apply equity preemption by using a two-step process. Under the first step of the analysis, *Travelers* and its progeny should be used, which might or might not lead to the preemption of state laws and lawsuits. Several general principles from *Travelers* are important to a first-step equity preemption analysis.

First, courts should not employ a literal application of either the "reference

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district court dismiss a plaintiff's federal lawsuit if there is an absent indispensable party over whom the court cannot assert federal subject matter or personal jurisdiction. *See* FED R. CIV. P. 19. One factor that might lead to an absent party being an indispensable party is that, under Rule 19(a), if "in the person's absence complete relief cannot be accorded among those already parties." FED. R. CIV. P. 19(a). In such a case, if the federal district court cannot fashion a remedy that would avoid prejudice to a person who is already a party to the lawsuit, the court "shall determine whether in equity and good conscience" the lawsuit should be dismissed because the absent party is indispensable to the lawsuit. *Id.* Importantly, "equity and good conscience" determines whether the lawsuit should be dismissed. Therefore, Rule 19 allows federal courts to use equity principles and maxims to decide when a lawsuit should be dismissed because an absent party is an indispensable party.

Furthermore, in conjunction with their equity analysis, courts should also consider "whether the plaintiff will have an adequate remedy if the action is dismissed for nonjoinder." FED. R. CIV. P. 19(b). Generally, a federal court should not dismiss a plaintiff's lawsuit because of an inability to join an indispensable party unless the plaintiff can refile her lawsuit in a state court where she can obtain subject matter and personal jurisdiction over all indispensable parties. *See* JACK H. FRIEDENTHAL ET AL., CIVIL PROCEDURE 352 (3d ed. 1999).

The relevancy of this discussion to this Article is twofold. First, when a federal court dismiss a lawsuit under Rule 19(b), the plaintiff normally will refile the case in state court, a fact that the court anticipates because it is a part of the court's consideration in deciding whether to dismiss the case. Second, the court loses jurisdiction to resolve the lawsuit if it cannot obtain subject matter or personal jurisdiction over an indispensable party and if "equity and good" conscious establish that a dismissal should occur. Therefore, Rule 19 is situation where the court gives up its jurisdiction over a case so that the appropriate state court can resolve the lawsuit after the joinder of all indispensable parties. The analogy to Rule 19 that impacts this Article, is that like a court that cannot obtain jurisdiction over an indispensable party, a federal court should use "equity preemption" to avoid the exercise of jurisdiction over some state law claims that have been removed to federal court along with section 502(a) claims (that are completely removal) by remanding the claims back to state court. Also, both federal courts and state courts, when they properly should retain jurisdiction of a state law claims, should use "equity preemption" to avoid the preemption of any state law claim when a plaintiff would not otherwise have a needed compensatory damage remedy. As such, both Rule 19 and ERISA preemption doctrines, including "equity preemption" would evidence courts use of their equity powers to provide necessary remedies to injured plaintiffs.

to" prong or the "connection with" prong of "relate to" since *Travelers* establishes that "the basic thrust of [ERISA's] pre-emption clause . . . [is] to avoid a multiplicity of regulation in order to permit the nationally uniform administration of employee benefit plans."[299] In other words, ERISA should preempt state laws and lawsuits only when they have a substantial impact on the structure or administration of an ERISA plan. Therefore, preemption should occur only when a state law or lawsuit substantially: (1) mandates employee benefit structures or their administration, (2) binds employers or plan administrators to particular choices or precludes uniform administrative practice, thereby functioning as a regulation of an ERISA plan itself, or (3) provides alternative enforcement mechanisms for employees to obtain ERISA plan benefits.[300] These types of laws and lawsuits generally limit or control an ERISA plan's administrative choices, and therefore, might result in a disuniformity of ERISA plan regulation if different states enact different laws on the same subject.[301] As such, they are generally inconsistent with ERISA's preemption clause purpose of avoiding a multiplicity of state law regulation. This Article calls these types of laws "structural state laws" because they tend to have a substantial effect on the structure and administration of ERISA plans.

Second, there should be no preemption even when a state law or lawsuit is a "structural state law" if the law or lawsuit has a "too tenuous, remote, or peripheral" effect on an ERISA plan.[302] Falling within this exception are laws and lawsuits that have only an indirect economic effect on an ERISA plan, as did New York's surcharges in *Travelers*.[303] An indirect economic effect primarily exists when a state law or lawsuit obligation might cause an ERISA plan to evaluate its administrative choices, but does not mandate that the plan choose one course of action over another.[304]

Third, given the presumption against the preemption of state law regulation in areas of traditional state authority, a court should not find preemption, even when a state law or lawsuit is a "structural state law" unless either ERISA's statutory language or legislative history clearly shows that Congress intended that the specific type of state law be preempted because the law interferes with ERISA's objectives and purposes.[305]

The above-referenced three principles stem from statements that the Supreme Court made in *Travelers* and they have evolved through some lower-level federal

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299. N.Y. State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co., 514 U.S. 645, 657 (1995).

300. *See id.* at 891-92. Generally, laws or lawsuits having the above-referenced substantial effects are thought of as having an impermissible "connection with" an ERISA plan, and therefore, ERISA preempts such claims. Cal. Div. of Labor Standards Enforcement v. Dillingham Constr., Inc., 519 U.S. 316, 329 (1997).

301. *See Travelers*, 514 U.S. at 657-58.

302. Shaw v. Delta Air Lines, Inc., 463 U.S. 85, 100 n.21 (1995).

303. *Travelers*, 514 U.S. at 659-60.

304. *See id.*

305. *See id.* at 654-55.

court decisions applying *Travelers* and ERISA's preemption clause on a case-by-case basis.[306] Moreover, these principles represent a narrowing of the scope of ERISA's preemption clause.[307]

Applying the three principles under the first step of an "equity preemption" analysis to medical malpractice lawsuits, a court should find that ERISA does not preempt either a medical malpractice claim against a treating physician or a vicarious liability claim against an HMO or other managed care organization that provides treating physicians because such claims normally have only an indirect effect on ERISA plans; and therefore, they generally fall within the "too tenuous, remote, or peripheral" exception to ERISA's preemption.[308] Importantly, these types of medical malpractice and vicarious liability claims are general state law regulation of the medical profession and the health care industry. Therefore, the presumption against preemption applies, and courts should find that ERISA does not preempt such claims because there is no clear expression from Congress that it intended to preempt state lawsuits that control the quality of health care,[309] including state common law medical malpractice claims against treating physicians and managed care organizations acting in their role as providers of medical care and state statutory provisions that impose a medical standard of care on medical providers in their role as providers, as in the Texas statute at issue in *Corporate Health Insurance*.[310]

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306. *See supra* notes 122-286.

307. Mostly, step one is an application of the current analysis under *Travelers* and the more progressive cases that have applied its rationale. *See Travelers*, 514 U.S. at 654-55.

308. *See generally* Lancaster v. Kaiser Found. Health Plan of Mid-Atl. States, Inc., 958 F. Supp. 1137 (E.D. Va 1997); Lazorko v. Pa. Hosp., No. 96-4858, 1998 WL 405055 (E.D. Pa. June 30, 1998), *aff'd in part and vacated in part*, 237 F.3d 242 (3d Cir. 2000); Dykema v. King, 959 F. Supp. 738 (D. S.C. 1997). There should especially be no preemption when a plaintiff's claim is based on either a treating physician's, an ERISA plan's, or a managed care organization's violation of an independent state law obligation and the claim seeks compensatory or other damages that are not actionable under section 502(a) of ERISA's civil enforcement provisions.

309. *See Lancaster*, 958 F. Supp. at 1149.

310. This conclusion is consistent with *Dukes*' distinction between physicians and medical providers acting in their medical provider roles where no preemption is proper, and their acting as administrators of ERISA plans, where some courts have been more willing to find preemption. In addition to negligent decisions during utilization review, ERISA plans, their managed care organization administrators, and treating physicians might be guilty of other misconduct that does not fall within the confines of a traditional state law claim for medical malpractice or vicarious liability. Regardless of the nature of the alleged improper conduct or the nature of the state common law theory of liability or applicable statutory provision, courts should generally find no preemption of such common-law theories or statutory provisions if the alleged conduct occurred during the ERISA plan's, the managed care organization's, and the treating physician's role as a provider of medical care. At this point in the analysis, the distinction between *Pilot Life* and *Dukes* as interpreted in *In re U.S. Healthcare* comes into play. If the plaintiff is seeking denied benefits because the ERISA administrator was allegedly negligent or otherwise acted improperly in denying the benefits, then under *Pilot Life*'s rationale the state-law claim should be preempted.

C. The Second Step of an Equity Preemption Analysis

The second step of an "equity preemption" analysis would come into play when, under the first step, the court reaches a conclusion that the disputed state law or lawsuit is a "structural state law," with an effect that is too substantial to fall within the "too tenuous, remote, or peripheral" exception to ERISA's preemption, but for which there is uncertainty as to whether Congress intended that ERISA preempt the law or lawsuit. The bottom line implication of an "equity preemption" analysis is that in situations where the scope of ERISA's preemption clause is uncertain, courts should not find a preemption of state laws if doing so means that beneficiaries will be left without an adequate compensatory damage remedy. Although other types of state laws and lawsuits might benefit from an analysis under the second step of an "equity preemption" analysis with its use of the maxim "equity will not suffer a wrong without a remedy," negligent utilization review decisions are ripe for this type of preemption analysis.

D. Negligent Utilization Review Decisions

At least three types of utilization review decisions are relevant to an "equity preemption" analysis: a pure eligibility decision, only a medication decision, and a "mixed eligibility and treatment decision." First, a pure eligibility decision is one where either the health plan or managed care organization makes a decision to deny or grant medical benefits without giving an opinion about the medical necessity of the treatment.[311] Traditionally, ERISA's preemption clause has

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However, if the plaintiff is seeking compensatory damages (and not denied benefits or other allowable equitable relief under section 502(a) of ERISA) because of a negligent medical decision or other acts of medical malpractice, then ERISA should not preempt the claim on *Dukes*' and *In re U.S. Healthcare*'s rationale that ERISA does not preempt claims seeking to hold an ERISA administrator liable for the provision of low quality or substantial benefits, instead of denied benefits. This result should adhere even when an ERISA administrator gives only medical advice regarding how the plaintiff should seek treatment for her medical condition or regarding how plaintiff's treating physician should treat plaintiff's medical condition. In either situation, a plaintiff would not have a claim under section 502(a) of ERISA's civil enforcement provision because her claim would be about a medical decision-quality of care issue and for compensatory damages. Since there would be no remedy under section 502(a), a court, through the use of its equity powers and the maxim "equity will not suffer a wrong without a remedy," should be able to either create a remedy itself or to hold that ERISA does not preempt the state law claim so that state law can create the remedy. From a federalism standpoint, finding no preemption, instead of a court's use of its equity powers to create a common law remedy, appears to be more in line with *Travelers*' admonition that the regulation of health care is a matter that has traditionally been left to state law regulation. Therefore, the use of equity preemption is consistent with the presumption against the preemption of state law regulation in areas of tradition state concerns.

311. This might occur when the treating physician, totally independent of the health plan or managed care organization, recommends treatment and the plan or organization denies the treatment

preempted state lawsuits challenging these types of benefit determination decisions because arguably they fall within *Pilot Life*'s preemption of state law claims that challenge "improper processing" of a request for benefits.[312] Preemption of state law claims for specific denied benefits would probably be appropriate even under an "equity preemption" analysis because ERISA's preemption clause should preempt a state law claim that seeks only the specific denied benefits that a plaintiff could obtain through filing an ERISA claim under section 502(a), especially as the challenged decision would be a pure eligibility decision.[313]

However, courts should be mindful of Justice Souter's admonition that *Travelers* "throws some cold water on the preemption theory."[314] Therefore, courts should not blindly follow *Pilot Life* to preempt all state law claims that arise during the utilization review process, but they should conduct a more rigorous analysis of state laws' impact on ERISA preemption clause purposes. In light of *Travelers* and *Pegram*, courts should make a distinction between state law claims that seek only the specific benefits that an ERISA plan or its affiliated managed care organization has denied, and state law claims that seek compensatory damages because of injures that a plaintiff has suffered due to either the ERISA plan's or its managed care organization's violation of independent state law obligations during the process of denying benefits.[315] ERISA should not preempt a state law claim for compensatory damages that seeks to vindicate the violation of independent state law obligations when the plaintiff is complaining about "only a medical decision."[316] This conclusion is consistent with the court's conclusion in *Crum* and in *Moreno*. The primary

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request without giving an opinion about whether the treatment is or is not medically necessary. *See* Pegram v. Herdrich, 120 S. Ct. 2143, 2144 (2000).

312. *See generally* Pilot Life Ins. Co. v. Dedeaux, 481 U.S. 41 (1987).

313. This result adheres through both conflict preemption and the *Pilot Life* rule that state law claims should not supplement the remedies provided by ERISA's civil enforcement provisions. *See id.* at 54.

314. *Pegram*, 120 S. Ct. at 2158.

315. The operative distinction should be whether the claim is based upon a violation of an independent state law obligation instead of a violation of either an ERISA's plan's terms and conditions or ERISA's statutory provisions. The distinction should not be based upon the type of damages that a plaintiff seeks, except that damages in the specific form allowable under section 502(a) of ERISA's civil enforcement provisions should not be allowed by means of a state law claim if the state law claim falls within the scope of the claims allowable under section 502(a). Therefore, other than claims for denied benefits, for enforcement of an ERISA's plan's terms and condition, or for resolution of dispute over rights to future benefits, one who brings a state law claim should be able to collect any state law remedies including compensatory damages, injunctions, and other applicable equitable relief.

316. ERISA should not preempt the claim unless the court can properly classify the claim as one for either a specific set of denied benefits or for other allowable equitable relief under ERISA's civil enforcement provisions, as opposed to a claim for compensatory damages for injuries flowing from negligence or other violations of independent state law obligations.

reason why there should be no preemption of these types of claims is that they challenge medical providers', managed care organizations', and ERISA plans' negligent decisions during their roles as medical providers and not solely their utilization review decisions. This same conclusion, that there should be no preemption of these types of claims, applies to what the *Pegram* Court called "mixed eligibility and treatment" decisions, which are not actionable as breaches of fiduciary duty claims under ERISA's civil enforcement provisions. They are not actionable because they involve a managed care organization's combined benefit eligibility decision and medical treatment decision.[317] Importantly, the Court in *Pegram* strongly implied that ERISA would not preempt state lawsuits challenging "mixed eligibility and treatment decisions," especially when the lawsuits involves an HMO's and its treating physicians' mixed decisions.[318] As a matter of fact, the Court relied on plaintiffs' apparent ability to bring state medical malpractice claims challenging "mixed eligibility and treatment decisions" as one reason supporting its decision in *Pegram* that managed care organizations are not acting in a fiduciary capacity when they make "mixed eligibility and treatment decisions."[319] Therefore, their decisions are not subject to challenge through an ERISA breach of fiduciary duty claim under either section 409(a) or section 502(a) of ERISA civil enforcement provisions.[320]

Implicit in *Pegram* is the Court's recognition that, at least as far as the medical treatment decision portion of a "mixed eligibility and treatment decision," state law obligations supply the quality control protection, and such protection falls within *Travelers*' presumption against the preemption of states' police power regulations.[321] Therefore, in furtherance of states' police power protection when the challenged act involves only a medical decision or a "mixed eligibility and treatment decision," "equity preemption" should apply and there should be no preemption of generally applicable state-law medical malpractice claims for compensatory damages, generally applicable state law claims vindicating relevant state law obligations, nor any generally applicable or specifically directed state statutory obligation.[322]

There are several reasons why the use of "equity preemption" should save state lawsuits based on the violation of independent state law obligations involving "only medical treatment decisions" and "mixed eligibility and

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317. *See Pegram*, 120 S. Ct. at 2158 (asserting that a breach of fiduciary duty claim under ERISA's civil enforcement provisions "would simply apply the law already available in state courts and federal diversity actions today, and the formulaic addition of an allegation of financial incentive would do nothing but bring the same claim into a federal court under federal-question jurisdiction").

318. *See id.*

319. *See id.*

320. *See id.*

321. This conclusion applies to state common law theories, state statutory provisions, and state laws based on the violation of state statutory provisions.

322. There is no reason why the "equity preemption" concept should not apply to all types of state laws.

treatment decisions." Most importantly, ERISA's civil enforcement provisions do not presently provide a remedy for these types of claims.[323] Beneficiaries are left without a meaningful compensatory damage remedy.[324] By using "equity preemption," especially regarding the "only medical decisions" and the "mixed eligibility and treatment decisions," courts can avoid preemption if the preemption of state laws and lawsuits would leave a beneficiary without an adequate compensatory damage remedy.[325] This result logically stems from the use of the maxim that "equity will not suffer a wrong without a remedy." However, some observers might raise several objections to the use of "equity preemption" to avoid the preemption of state law claims challenging either an ERISA plan's or affiliated managed care organization's negligent acts during utilization review.

E. Responses to Potential Arguments Against the Use of Equity Preemption

First, one might argue that allowing a state law claim for compensatory damages, stemming from a violation of independent state law obligation, would be an impermissible alternative enforcement mechanism because it would provide a compensatory damage remedy when ERISA's civil enforcement provisions provide only for denied benefits and non-monetary equitable relief.[326] The short answer to this concern is that *Travelers*' prohibition against state law claims that seek to establish an alternative enforcement mechanism speaks only against a claim for denied benefits.[327] Because a state law claim for compensatory damages for a violation of state statutory provisions or common law doctrine is not for denied benefits, but for personal injuries flowing from an ERISA plan administrator's or managed care organization's negligent conduct or other improper actions during the utilization review process, the claim should not violate the rule against state laws providing an alternative enforcement mechanism.[328]

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323. "Mixed eligibility" and treatment claims, pursuant to *Pegram*, are not actionable under either section 502(a) or section 409(a) because they do not fall within the fiduciary duty of a managed care organization. *See Pegram*, 120 S. Ct. at 2158.

324. *See Mertens*, 508 U.S. 240 (1993).

325. As the amount of denied benefits are the only monetary remedy under section 502(a), there is not adequate remedy under section 502(a) for compensatory damages based on a violation of independent state laws.

326. *See supra* note 20.

327. *See* Corporate Health Ins., Inc. v. Tex. Dep't of Ins., 12 F. Supp. 2d 597, 628-29 (S.D. Tex. 1998), *aff'd in part and rev'd in part*, 215 F.3d 526 (5th Cir. 2000).

328. The only limitation on the type of state laws and lawsuits that should escape ERISA's preemption is that the above arguments should apply only to generally applicable state laws that are not specifically directed at the regulation of ERISA plans. Specifically directed laws are the ones that are in danger of running afoul of ERISA's preemption. They are a direct regulation of ERISA plans and would be contrary to ERISA's preemption clause purpose of avoiding a disuniformity of regulation of ERISA plans, as different states might enact different state laws that might place a

Second, some might assert that ERISA's civil enforcement provisions preempt the field of state law remedies such that one cannot use state law to obtain remedies that are not allowable under ERISA's civil enforcement provisions. This argument would be consistent with the assertions from some members of the Court that field preemption should be used to resolve ERISA's preemption issues.[329] However, the Court's prior cases have not used field preemption to determine the scope of ERISA's express preemption.[330]

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substantial burden on the operation of multi-state ERISA plans.

329. Justice Scalia's concurring opinion in *Dillingham Construction* asserts that the Court's ERISA preemption jurisprudence is essentially an application of the field preemption doctrine. Cal. Div. of Labor Standards Enforcement v. Dillingham Constr., Inc., 519 U.S. 316, 334-35 (1997) (Scalia, J., concurring). Field preemption occurs when (1) there is a "scheme of federal regulation [that is] so pervasive as to make reasonable the inference that Congress left no room for the States to supplement it," and (2) when "an Act of Congress 'touch[es] a field in which the federal interest is so dominant that the federal system will be assumed to preclude enforcement of state laws on the same subject." English v. Gen. Elec. Co., 496 U.S. 72, 79 (1990) (citing Rice v. Sante Fe Elevator Corp., 331 U.S. 218, 230 (1947)).

330. *See Dillingham Constr.*, 518 U.S. at 333-34. At least one lower-level federal court has reasoned that ERISA's preemption is based on both express preemption and field preemption. *See* Kanalos v. Graham, 759 F. Supp. 374 (E.D. Mich. 1991). The *Kanalos* court stated "[i]t is by a combination of the first two of these circumstances, express preemption and field preemption, under which ERISA has been found to preempt state law." *Id.* at 376 However, the court's conclusion that ERISA did not preempt the employee's state law fraud, promissory estoppel, and breach of contract claims was based on express preemption doctrine and not field preemption. *See id.* at 378.

In any event, some of the Supreme Court's opinions do not lead to the conclusion that field preemption is applicable to an ERISA preemption analysis. For example, in *District of Columbia v. Greater Washington Board of Trade* 506 U.S. 125 (1992), the Court applied a literal interpretation of "relate to" to preempt a Washington workers' compensation law that merely had a "reference to" ERISA plans despite the fact that ERISA exempted state workers' compensation laws from ERISA regulation. *See id.* at 128-31. The workers' compensation law provided:

> Any employer who provides health insurance coverage for an employee shall provide health insurance coverage equivalent to the existing health insurance coverage of the employee while the employee receives or is eligible to receive workers' compensation benefits under this chapter.

Id. at 128.

The Court held that ERISA preempted the law because of its "reference to" ERISA benefit plans that were the source of the existing health insurance referenced in the text of the workers' compensation law. The Court reasoned:

> Section 2(c)(2) of the District's Equity Amendment Act specifically refers to welfare benefit plans regulated by ERISA and on that basis alone is pre-empted. The health insurance coverage that § 2(c)(2) requires employers to provide for eligible employees is measured by reference to "the existing health insurance coverage" provided by the employer and "shall be at the same benefit level." The employee's "existing health insurance coverage," in turn, is a welfare benefit plan under ERISA § 3(1), because it involves a fund or program maintained by an employer for the purpose of providing

Rather, the Court has used an express preemption analysis to interpret the effects of ERISA's civil enforcement provisions.[331] Furthermore, given the similarities between an ERISA express preemption analysis and a field preemption analysis, most cases would obtain the same preemption conclusion under a field preemption analysis as under ERISA's express preemption, especially since some of the same general principles apply to both types of preemption.[332]

For example, as with ERISA's express preemption, the Supreme Court appears hesitant to apply field preemption in areas of state law regulation "that

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> health benefits for the employee "through the purchase of insurance or otherwise." Such employer-sponsored health insurance programs are subject to ERISA regulation and any state law imposing requirements by reference to such covered programs must yield to ERISA.

Id. at 130-31 (citations omitted). In his argument against preemption of Washington's law, Justice Stevens' dissenting opinion implies that ERISA preemption clause implicates a field preemption analysis. However, Justice Stevens correctly asserts that some of the Court's prior opinions have established an interpretation of ERISA's preemption clause that is broader than field preemption. *See id.* at 136 (Stevens, J., dissenting). This is especially the case when the Court has found preemption when a state statute, although not directly regulating an ERISA plan, "make[s] it necessary for plan administrators to operate such plans differently." *Id.* Justice Stevens states:

> In deciding where that line should be drawn, I would begin by emphasizing the fact that the so-called "pre-emption" provision in ERISA does not use the word "pre-empt." It provides that the provisions of the federal statute shall "supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan described in section 1003(a) of this title and not exempt under section 1003(b) of this title." Thus the federal statute displaces state regulation in the field that is regulated by ERISA; it expressly disavows an intent to supersede state regulation of exempt plans; and its text is silent about possible pre-emption of state regulation of subjects not regulated by the federal statute. Thus, if we were to decide this case on the basis of nothing more than the text of the statute itself, we would find no pre-emption (more precisely, no "supersession") of the District's regulation of health benefits for employees receiving workers' compensation because that subject is entirely unregulated by ERISA. I would not decide this case on that narrow ground, however, because both the legislative history of ERISA and prior holdings by this Court have given the supersession provision a broader reading. Thus, for example, in *Shaw* itself we held that the New York Human Rights Law, which prohibited employers from structuring their employee benefit plans in a manner that discriminated on the basis of pregnancy, was pre-empted even though ERISA did not contain any superseding regulatory provisions. State laws that directly regulate ERISA plans, or that make it necessary for plan administrators to operate such plans differently, "relate to" such plans in the sense intended by Congress.

Id. at 136-37. His contentions were based on the fact that ERISA exempts the regulation of workers' compensation plans from ERISA's preemption, and that the preempted workers' compensation law did not regulate ERISA plans. *Id.* (citing Shaw v. Delta Air Lines, Inc., 463 U.S. 85, 98 (1983)).

331. *See supra* note 330.

332. *See infra* notes 333-35.

have 'been traditionally occupied by the State.'"[333] Second, the "too tenuous, remote, or peripheral" exception to ERISA's express preemption has a counterpart in the field preemption arena to the extent that laws with such an impact would also not be preempted under a field preemption analysis.[334]

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333. *See also* Medtronic, Inc. v. Lohr, 518 U.S. 470 (1996). In *Medtronic*, the Court held that the express preemption clause of the Medical Device Amendments of 1976 (MDA), which imposed requirements on the sale and marketing of medical devices, did not preempt state law negligence claims and strict product liability claims based on the improper design, manufacturing and labeling of a Medtronic's pacemaker lead. *See id.* at 502-03. The MDA's expressed preemption clause provided for preemption only when a state requirement is different from, or in addition to, any requirement imposed by the MDA or the regulating agency. *Id.* at 481 (citing 21 U.S.C. § 360k(a)). Further, the Court held that the preemption clause covered only specific, conflicting state legislative enactments directed at a specific medical device and not a state's generally applicable common law causes of action. *See id.* at 486-91. Therefore, the Court, pursuant to its interpretation of the express preemption clause, and the MDA's implementing regulations, found that the state law claims were not preempted. *See id.* at 501. In his concurring opinion, Justice Breyer, responded to Justice O'Connor's dissenting opinion's reference to the "'comprehensive' and 'extensive'" nature of the MDA's regulations of the manufacturing and labeling of medical devices. *Id.* at 513-14 (O'Connor, J., dissenting). He asserted: "[T]his Court has previously said that it would 'seldom infer, solely from the comprehensiveness of federal regulations, an intent to pre-empt in its entirely a field related to health and safety." *Id.* at 507 (Breyer, J., concurring) (citing Hillsborough County v. Automated Med. Labs., Inc., 471 U.S. 707, 718 (1985)). Although Justice O'Connor did not specifically mention field preemption, given that she spoke only of the extensive nature of the regulation as a ground for preemption, without identifying any particular conflict between the respondent's state common-law claim and the MDA statute and regulations, Justice Breyer's references to field preemption appear well-grounded. *See id.* at 513-14 (O'Connor, J., dissenting).

Medtronic, especially Justice Breyer's references to field preemption, might have implications for ERISA's preemption, especially if the Court accepts field preemption as the controlling doctrinal approach to preemption in this area. The major argument would be that simply because ERISA's section 502(a) civil enforcement provisions are arguably comprehensive and complete does not necessarily mean that one cannot bring a state common law cause of action unless there is some other indication that Congress intended to preempt the field for federal regulation. Justice Breyer states:

> I can find no actual conflict between any federal requirement and any of the liability-creating-premises of the plaintiffs' state law tort suit; nor, for the reasons discussed above, can I find any indication that either Congress or the FDA intended the relevant FDA regulation to occupy entirely any relevant field.

Id. at 508 (Breyer, J., concurring).

334. *See* N.W. Cent. Pipeline Corp. v. State Corp. Comm'n of Kan., 489 U.S. 493 (1989). In *Northwest Pipeline*, the State Corporation Commission of Kansas (KCC) issued an order "to provide for the permanent cancellation of underages" that an interstate gas pipeline accrued in withdrawing gas for common gas pools. *Id.* at 503. Northwest Pipeline contended that the National Gas Policy Act of 1978 (NGPA) preempted the Kansas order because in canceling underages the order affected the price that pipelines could charge for gas that they transported through interstate commerce. *See id.* at 510. Importantly, the NGPA provided that states could regulate the

Third, consistent with express preemption, to support an inference that field preemption trumps a state law, Congress' intent to employ field preemption must be "clear and manifest" as expressed in either a federal statute, supporting legislative history, or a regulatory agency's enforcement rules.[335] These principles lead to the conclusion that, in comparison to ERISA's express preemption, the use of field preemption to resolve ERISA's preemption issues would not be a substantial improvement over the Court's current express preemption analysis.

In any event, section 502(a) of ERISA's civil enforcement provisions does not clearly and manifestly show that Congress' intent is that ERISA's civil enforcement provisions preempt state law remedies that are based upon violations of independent state law obligations. This observation leads to the

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"production or gathering of natural gas." *Id.* at 507. On the other hand, the federal government had the exclusive authority "to regulate the wholesale pricing of natural gas in the flow of interstate commerce from wellhead to delivery to consumers." *Id.* The Court rejected the field preemption argument because Kansas' order fell within states' authority to control the production of natural gas within their boundaries. *See id.* at 511-12. In *Northwest Pipeline*, despite the fact that the state order indirectly increased the price of natural gas that pipelines transported in interstate commerce, the Court found that such an indirect effect on the price of gas did not intrude on the federal government's exclusive authority to regulate the interstate price of natural gas. *See id.* The Court reasoned that any exercise of a state's authority to regulate the production of natural gas would have some effect on the price of interstate gas. *See id.* at 512-13. The only way that the Kansas order would result in preemption was if Kansas, in issuing the order, had the purpose of regulating the price of interstate gas instead of regulating the production of gas within its local boundaries. *See id.* at 518. Such an ulterior purpose would have probably resulted in both field preemption and conflict preemption. Therefore, in *Northwest Pipeline*, the field preemption doctrine did not preempt a Kansas order canceling "underage" despite the order's indirect effect on interstate gas prices, even though the regulation of interstate gas prices was within the federal government's exclusive authority. *See id.* at 526.

335. *See* P.R. Dep't of Consumer Affairs v. Isla Petroleum Corp., 485 U.S. 495, 503 (1988). In one respect, ERISA's statutory scheme does not show a "clear and manifest" congressional intent that states have no regulatory role in the employment benefit field. The presence of ERISA's saving clause is clear evidence that Congress did envision a state role in regulating the business of insurance since the saving clause exempts state insurance laws from ERISA's preemption. *See* 29 U.S.C. § 1144 (b)(2)(A) (1988). Under the saving clause, numerous state laws have been saved from preemption. *See generally* Larry J. Pittman, *"Any Willing Provider" Laws and ERISA's Saving Clause: A New Solution for an Old Problem*, 64 TENN. L. REV. 409 (1997). This is significant because when Congress has wanted to, it has delineated those portions of the employee benefit field that should be subject to exclusive federal regulation. For example, the "deemer clause" makes the saving clause's exemption inapplicable to self-funded or self-insured welfare benefit plans. *See* 29 U.S.C. § 1144 (b)(2)(B) (1988). Given the distinction between insured plans that states can regulate, and self-insured plans that states cannot regulate, ERISA's legislative history statements, that ERISA's preemption clause provides for exclusive federal regulation of employee benefit plans, cannot be taken literally. 120 CONG. REC. 15737, 15742 (statement of Sen. Williams).

logical conclusion that the Court has misinterpreted congressional intent regarding the preemptive effects of ERISA's civil enforcement provisions. For example, in *Pilot Life*, the issue before the Court was whether ERISA preempted a Mississippi bad faith claim for an improper processing of a claim for disability benefits.[336] To support its conclusion in favor of preemption, the Court made several broad statements regarding ERISA's section 502(a) being an expression of Congress' intent regarding the preemption of state laws. First, the Court stated: "The deliberate care with which ERISA's civil enforcement remedies were drafted and the balancing of policies embodied in its choice of remedies argue strongly for the conclusion that ERISA's civil enforcement remedies were intended to be exclusive."[337] One could argue that this statement means that one who has a claim against an ERISA welfare benefit plan for any type of injury must limit her remedies to those allowable under section 502(a).[338]

However, to support a field preemption of state laws, Congress' intent regarding the preempted field must be "clear and manifest" from either ERISA's expressed statutory language or from its relevant legislative history.[339] Therefore, it is significant that the language of section 502(a) is clear and manifest only regarding the civil enforcement remedies for a breach of an ERISA plan's contractual language[340] and for a breach of ERISA's substantive provisions.[341] It clearly and manifestly provides for a claim to recover denied benefits, enforce rights under the terms of the plan, or to clarify rights to future benefits under the terms of the plan.[342] The language does not speak either positively or negatively about state law claims based upon violations of independent state law obligations that seek compensatory damages. Therefore, from a strict interpretation of section 502(a)'s language, the only field that ERISA's civil enforcement provisions preempt is state laws that impose liability for a violation of the terms of an ERISA plan or for a violation of ERISA's substantive provisions and which seek the specific remedies allowable under section 502(a).[343] The legislative history that the Court cited in *Pilot Life* does not alter this conclusion.

First, the *Pilot Life* Court emphasized ERISA's legislative history that "civil actions may be brought by a participant or beneficiary to recover benefits due under the plan, to clarify rights to receive future benefits under the plan, and for relief from breach of fiduciary responsibility."[344] Those lawsuits shall be deemed "arising under the laws of the United States in similar fashion to those brought

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336. *See* Pilot Life Ins. Co. v. Dedeaux, 481 U.S. 41, 43-44 (1987).
337. *Id.* at 54.
338. *See id.*
339. *See P.R. Dep't of Consumer Affairs*, 485 U.S. at 503.
340. *See Pilot Life*, 481 U.S. at 55.
341. *See* 29 U.S.C. § 1132 (a) (1988).
342. *See id.*
343. *See id.*
344. *Pilot Life*, 481 U.S. at 55.

under section 301 of the Labor-Management Relations Act of 1947 (LMRA)."[345] The Court proceeded to note that, under section 301 of the LMRA, all state law claims "for violation of contracts between an employer and a labor organization," even when the state action purported to authorize a remedy unavailable under the federal provision, are preempted.[346] Importantly, the Court then stated that "[i]n *Lucas Flour* the Court found that '[t]he dimensions of § 301 require the conclusion that substantive principles of federal labor law must be paramount in *the area covered by the statute*.'"[347] The area covered by the statute was the violation of contractual terms between employers and employees.[348]

Applying the Court's observation about the preemptive effects of the LMRA to the preemptive effects of section 502(a) of ERISA's civil enforcement provisions, one should conclude that the relevant area of federal preemption is the area covered by the language of section 502(a). That area is lawsuits by participants and beneficiaries challenging an ERISA plan's violation of either the terms of an ERISA welfare benefit plan or the substantive provisions of ERISA itself, and not lawsuits alleging a violation of an independent state law obligation. This conclusion is not altered by ERISA's legislative history. For example, the Court in *Pilot Life* concluded that, "Congress' specific reference to § 301 of the LMRA to describe the civil enforcement scheme of ERISA, makes clear its intention that all suits brought by beneficiaries or participants *asserting improper processing of claims* under ERISA-regulated plans be treated as federal questions governed by § 502(a)" because they in essence allege that an ERISA plan has violated the *contractual terms* of an ERISA plan by improperly denying *benefits*.[349] A strict reading of the Court's statements is that the Court's interpretation of ERISA's legislative history's reference to section 301 of the LMRA means only that state law claims seeking remedies for an "improper processing" of claims for plan benefits, and alleging a breach of contractual terms, are preempted by section 502(a) through field preemption. Therefore, field preemption should not preempt state law claims that are not based upon "an improper processing" of claims for denied benefits, but are premised on the violation of an independent state law obligations and not on a violation of the terms and condition of an ERISA plan. There is no "clear and manifest" expression of Congress' intent to preempt such claims.

One might allege that despite the absence of any language in section 502(a) explicitly preempting state claims alleging theories other than a violation of either an ERISA plan's terms, an ERISA statutory provision, or "an improper processing of claims," the comprehensiveness of federal regulation of the welfare benefit field means that there is no room left for states to regulate in the welfare benefit field.[350] However, other than section 409(a), section 502(a), and the

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345. *Id.*

346. *Id.*

347. *Id.* (emphasis added).

348. *See id.* at 56.

349. *Id.*

350. The comprehensiveness of federal regulation is one factor that could, in an appropriate

portion of the statute establishing fiduciary standards of conduct, there is no extensive and comprehensive federal regulation of employee welfare benefit plans, especially as to the quality of medical care that an ERISA plan and affiliated managed care organization provide to ERISA beneficiaries.[351] One is left with asserting that section 502(a)'s civil enforcement provisions are the relevant source for measuring the comprehensiveness of Congress' regulation of remedies flowing from either a breach of a welfare benefit plan or a breach of ERISA's statutory provisions. However, the language of section 502(a) does not clearly and manifestly show a congressional intent that ERISA's civil enforcement provisions should preempt state law claims alleging theories (other than one based on an improper processing of a specific benefit request) that are premised on independent state law obligations. Contrary to the *Pilot Life* Court's assertion, there is no persuasive evidence that Congress, as far as independent state law obligation is concerned, considered and rejected other theories of liability and remedies. Given the presumption against the preemption of state's historical police power regulations (including the regulation of the quality of medical care), any uncertainty about congressional intent to preempt state law theories should be resolved against preemption of those theories.[352]

Furthermore, the general legislative history statements about the scope of ERISA's preemption do not clearly and manifestly establish that field preemption proscribes all state law tort claims and remedies against those affiliated with or those managing ERISA welfare benefit plans. A common theme throughout ERISA's legislative history is that Congress was primarily concerned about state laws that attempted to "regulate" how private pension plans and welfare benefits plans operated within the states. The operative term is "regulate." For example, Senator Williams, one of ERISA's sponsors, stated:

> It should be stressed that with the narrow exceptions specified in the bill, the substantive and enforcement provisions of the conference substitute are intended to preempt the field for Federal *regulations*, thus eliminating the threat of conflicting or inconsistent State and local *regulation* of employee benefit plans. This principle is intended to apply in its broadest sense to all actions of State or local governments, or any instrumentality thereof, which have the force or effect of law.[353]

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case, lead to field preemption. *See* English v. Gen. Elec. Co., 496 U.S. 72, 79 (1990).

351. *See* Jana K. Strain & Eleanor D. Kinney, *The Road Paved with Good Intentions: Problems and Potential for Employer-Sponsored Health Insurance Under ERISA*, 31 LOY. U. CHI. L.J. 29, 50 (1999).

352. The presumption applies even when field preemption is used. *See* Medtronic, Inc. v. Lohr, 518 U.S. 470, 507 (1996).

353. 120 CONG. REC. 15737, 15742 (statement of Sen. Williams) (emphasis added). Senator Williams further asserted that:

> This principle is intended to apply in its broadest sense to all actions of State or local governments, or any instrumentality thereof, which have the force or effect of law. Consistent with this principle, State professional associations acting under the guise of

Similarly, Senator Javits, another ERISA sponsor, asserted:

> Although the desirability of further *regulation*—at either the State or Federal level—undoubtedly warrant further attention, on balance, the emergence of a comprehensive and pervasive Federal interest and the interests of uniformity with respect to interstate plans required-but for certain exceptions-the displacement of State action in the field of private employee benefit programs. The conferees-recognizing the dimensions of such a policy-also agreed to assign the Congressional Pension Task Force the responsibility of studying and evaluating preemption in connection with State authorities and reporting its findings to the Congress. If it is determined that the preemption policy devised has the effect of precluding *essential legislation* at either the State or Federal level, appropriate modifications can be made.
>
> In view of Federal preemption, *State laws compelling disclosure from private welfare or pension plans, imposing fiduciary requirements on such plans, imposing criminal penalties on failure to contribute to plans-unless a criminal statute of general application-establishing State termination insurance programs, et cetera, will be superseded.* It is also intended that a body of Federal substantive law will be developed by the courts to deal with issues involving rights and obligations under private welfare and pension plans.[354]

Both Senator Williams' and Javits' statements seem to be primarily concerned with states passing statutes to directly regulate ERISA employee benefit plans. As such, the Supreme Court arguably misinterpreted Senator Javits' statement in *Shaw v. Delta Air Lines, Inc.*,[355] when the Court stated:

> In fact, however, Congress used the words "relate to" in § 514(a) in their broad sense. To interpret § 514(a) to preempt only state laws specifically designed to affect employee benefit plans would be to ignore the remainder of § 514(a). It would have been unnecessary to exempt generally applicable state criminal statutes from pre-emption in § 514(b), for example, if § 514(a) applied only to state laws dealing specifically with ERISA plans.[356]

> State-enforced professional regulation, should not be able to prevent unions and employers from maintaining the types of employee benefit programs which Congress has authorized-for example, prepaid legal services programs-whether closed or open panel-authorized by Public Law 93-95.

Id.

354. 120 CONG. REC. 15737, 15751 (statement of Sen. Javits) (emphasis added).

355. 463 U.S. 85 (1983).

356. *Id.* at 98. To the contrary, the distinction could have been simply for the purpose of emphasizing the different types of state laws that might be preempted, and to make clear that generally applicable state criminal laws escape ERISA preemption.

Contrary to the Court's interpretation, Senator Javits' statement is more susceptible to an interpretation that Congress was primarily concerned about states passing criminal laws,, and other types of laws, for the direct purpose of regulating ERISA benefit plans. This is shown by a portion of Senator Javits' above-quoted statement: "In view of Federal preemption, State laws compelling disclosure from private welfare or pension plans, imposing fiduciary requirements on such plans, *imposing criminal penalties on failure to contribute to plans-unless a criminal statute of general application*-establishing State termination insurance programs, et cetera, will be superseded."[357]

The gist of Senator Javits' statement seems to express a congressional intent to preempt state statutes designed specifically to regulate employee welfare benefit plans. The portion of his statement regarding the exemption of state criminal laws of general applicability, that the Court in *Pilot Life* interpreted to mean that ERISA's preemption clause reaches general state laws that were not specifically enacted to regulate employee benefit plans, seems specifically for the purpose of showing that when states specifically pass criminal laws to regulate employee benefit plans that those laws are preempted. This is shown by Senator Javits' statement's emphasis on the preemption of state laws "*imposing criminal penalties on failure to contribute to plans-unless a criminal statute of general application.*"[358] Obviously, the congressional concern was about states that pass laws specifically to regulate ERISA plans. If that were not the case, there would have been no need for Senator Javits and Congress to make a distinction between criminal laws specifically directed towards ERISA plans and those of general applicability.[359] Senator Javits' statement regarding generally applicable criminal laws appear to be Congress' effort to recognize states' general authority to proscribe criminal activity. One could infer that congressional respect for states' criminal law authority was so strong that, despite a congressional intent to create a uniformity of regulation for ERISA plans, Congress intended that ERISA's preemption clause not supersede state generally applicable criminal laws.

However, because neither ERISA's statutory language nor its legislative history specifically refers to non-criminal state laws of general applicability,

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357. 120 CONG. REC. 15737, 15751 (statements of Sen. Javits) (emphasis added).

358. *Id.* (emphasis added).

359. ERISA's preemption clause preempted the former while the latter was not preempted. Apparently, the generally applicable criminal laws were not preempted out of a congressional concern to respect states' authority to proscribe criminal activity through generally applicable statutes. In any event, it seems a dubious proposition for the U.S. Supreme Court to base a substantial portion of its ERISA jurisprudence on a tenuous conclusion from Senator Javits' statements and from the ERISA preemption clause. The Court found that the congressional intent was that ERISA preempts all generally applicable laws simply because Senator Javits' statement and the preemption clause itself exclude generally applicable criminal laws from ERISA's preemption. 29 U.S.C. § 1144(b)(4) (1994). In light of *Travelers*, any uncertainty regarding ERISA's preemption of generally applicable state laws should be resolved against the preemption of these laws.

under either express or field preemption doctrines there is no clear and manifest expression of congressional intent regarding the preemption of generally applicable tort laws not designed to specifically regulate employee benefit plans. Therefore, the nutshell response to an allegation that ERISA's civil enforcement provisions preempt state law remedies based on independent state law obligations is that such contentions have no merit when a state law claim does not fall within the specific scope of the claims allowable under section 502(a) of the civil enforcement provisions.

Additionally, an analysis of section 301 of the LMRA shows that there are several principles that caution against a use of section 502(a) of ERISA's civil enforcement provisions to preempt independent state law obligations that are not premised on either the terms of an ERISA plan or on a violation of ERISA's substantive provisions. For example, section 301 will preempt a state law claim only if it is based directly on either rights created by a collective bargaining agreement or if it is "substantially dependent on an interpretation of a collective bargaining agreement."[360] One court has stated:

> A court's determination of whether a state law claim is preempted by § 301 "must focus . . . on whether [the state law claim] confers nonnegotiable state-law rights on employers or employees independent of any right established by contract, or, instead, whether evaluation of the [state law] claim is inextricably intertwined with consideration of the terms of the labor contract."[361]

Furthermore, if the terms of a collective bargaining agreement are not in dispute, a mere examination of, or review of, the agreement is not sufficient to cause the preemption of a state law.[362]

The court's decision in *Roessert v. Health Net*[363] is instructive. In that case, the plaintiff was a member of an ERISA employee benefit plan.[364] The ERISA plan had a contract with an HMO that required the HMO to provide medical care to plaintiff.[365] In turn, the HMO had a contract with several medical groups that supplied primary care physicians who treated the plaintiff.[366] On several occasions, the plaintiff requested but did not receive sufficient medical treatment from the primary care physicians.[367] At some point, the HMO, without plaintiff's consent, allegedly contacted one of its primary care physician groups and allegedly instructed a physician to assist the plaintiff's husband in obtaining a

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360. Aguilera v. Pierelli Armstrong Tire Corp., 223 F.3d 1010, 1014 (9th Cir. 2000).

361. Firestone v. S. Cal. Gas Co., 219 F.3d 1063, 1065 (9th Cir. 2000).

362. *See Aguilera*, 223 F.3d at 1014; *Firestone*, 219 F.3d at 1065 ("When the meaning of particular contract terms is not disputed, the fact that a collective bargaining agreement must be consulted for information will not result in § 301 preemption.").

363. 929 F. Supp. 343 (N.D. Cal. 1996).

364. *See id.* at 346.

365. *See id.*

366. *See id.*

367. *See id.* at 346-47.

confinement of plaintiff to a psychiatric institution because of her alleged suicidal tendencies.[368] Plaintiff brought a medical malpractice suit alleging that the HMO and the primary care physician were negligent in recommending plaintiff's confinement.[369] Defendants removed the lawsuit to federal court, alleging that ERISA preempted plaintiff's claims because she complained of defendants' conduct during the administration of benefits under an ERISA plan.[370]

The federal district court remanded the case to state court, finding that complete preemption was not proper because plaintiff's lawsuit did not fall within the scope of section 502(a) of ERISA's civil enforcement provisions.[371] The plaintiff was not seeking denied benefits but was complaining about the quality of defendants' alleged medical decision to recommend plaintiff's confinement to a psychiatric institution.[372] In other words, the lawsuit challenged defendants' conduct as medical providers, not as administrators of ERISA benefits, because defendants' actions allegedly were not in response to a specific request by plaintiff for medical benefits. Rather, defendants' actions allegedly were pursuant to their own efforts to recommend a certain course of treatment for plaintiff. In regards to the connection between section 301 of the LMRA and section 502(a) of ERISA's civil enforcement provisions, the court acknowledged that the Supreme Court has used section 301 "to interpret the preemptive scope of section 502(a)" and that "the appropriate inquiry is whether the claim 'rests upon the terms of the plan' or requires construction of plan language."[373] The court concluded that "the question of whether [defendant's] alleged recommendation of specific treatment for [plaintiff] was negligent can surely be decided apart from the terms of the plan."[374] As such, section 502(a) of ERISA's civil enforcement provisions did not completely preempt plaintiff's malpractice claims.[375] Although *Roessert* primarily involves a complete preemption issue, it supports the conclusion that, like section 301 of the LMRA, section 502(a) of ERISA's civil enforcement provisions does not preempt state lawsuits that are based upon independent state law obligations that do not allege a violation of either ERISA's statutory provision or the terms and conditions of an ERISA plan, nor seek the specific type of damages allowable under section 502(a).

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368. *See id.* at 347.

369. *See id.*

370. *See id.*

371. *See id.* at 350-51.

372. *See id.*

373. *Id.* at 351.

374. *Id.*

375. The court left open the issue whether ERISA's preemption clause preempted the claim. *See id.* at 353.

CONCLUSION

The bottom line of the above-stated "equity preemption" analysis is that, generally, unless the plaintiff's state law claim falls within section 502(a) and seeks the types of remedies allowable under that section, ERISA should not preempt the claim. More specifically, ERISA's preemption clause should not preempt state law claims that seek compensatory damages based on an ERISA plan's or its affiliated managed care organization's violation of independent state law obligations. Through the use of "equity preemption" and the maxim "equity will not suffer a wrong without a remedy," federal courts should prevent the preemption of these types of claims, as more specifically discussed above. This conclusion is proper despite the federal court cases that have held that the absence of an ERISA remedy does not prevent ERISA from preempting a state law claim that "relates to" an ERISA plan.[376] The best interpretation of these

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376. *See* Bast v. Prudential Ins. Co. of Am., 150 F.3d 1003, 1009-10 (3d Cir. 1998) (holding that the absence of an ERISA remedy did not prevent the preemption of state law claims complaining of a bad faith denial of autologous bone marrow transplant procedure (ABMT) benefits, a claim that was cognizable under ERISA's civil enforcement provision); Cannon v. Group Health Serv. of Okla., Inc., 77 F.3d 1270, 1272 (10th Cir. 1996) (holding that the absence of ERISA remedy did not prevent preemption of state law claim for negligence and bad faith denial of ABMT when claim was cognizable under ERISA's civil enforcement provision); Tolton v. Am. Biodyne, Inc., 48 F.3d 937, 943 (6th Cir. 1995) (distinguishing instant case on the grounds that the preempted state-law claims fell within the type of claim that could have been brought under ERISA's civil enforcement provision, and thereby recognizing a distinction between the non-preemption of a state law claim when it could not have been brought under ERISA's civil enforcement provision and the preemption of a state law claim that could have been brought under ERISA's civil enforcement provision); Corcoran v. United Health Care, Inc., 965 F.2d 1321, 1333 (5th Cir. 1992) (holding that ERISA preempted a state wrongful death claim based on an ERISA administrator's denial of requested medical treatment despite the fact that ERISA did not provide a remedy when the preempted claim was cognizable under ERISA's civil enforcement provision, which would not have granted a compensatory damage remedy).

Dependhal v. Falstaff Brewing Corp., 653 F.2d 1208 (8th Cir. 1981), appears to be the first case where a court implied that ERISA would not preempt a state law claim when ERISA did not provide a remedy for the alleged wrongful conduct. *See id.* at1215-16. However, the court held that preemption was appropriate because ERISA did provide a remedy. *See id.* at 1216. Subsequently, the Sixth Circuit in *Perry v. P*I*E Nationwide, Inc.*, 872 F.2d 157 (6th Cir. 1989), interpreted *Dependhal* as holding "that preemption should apply to a state law claim only if Congress has provided a remedy for the wrong or wrongs asserted." *Id.* at 162. In *Perry*, the court sustained the lower court's opinion (as to plaintiffs' fraud, misrepresentation, and promissory estoppel claims) that ERISA did not preempt plaintiffs' state law claims, which, instead of seeking denied benefits under an ERISA plan, sought a holding that plaintiffs not be considered as participants in an ERISA plan that their employer allegedly, through fraud, induced them to participate in by using misrepresentation. *See id.* The gist of the Sixth Circuit's opinion appears to be the court's acceptance of the lower court's conclusion that plaintiffs' state law claims were not cognizable under ERISA's civil enforcement provision; and therefore, ERISA should not

cases is that if plaintiff's state law claim is cognizable under section 502(a), the absence of an ERISA remedy (or a sufficient ERISA remedy) is not a bar to ERISA's preemption of the state law claim.[377] However, if the state law claim is premised on a theory and seeks remedies that are not actionable under section 502(a), the absence of an ERISA remedy (especially a compensatory damage remedy) and cause of action should mean that ERISA does not preempt the state law claim. This conclusion is all the more appropriate when courts, even in the face of criticism against the use of equity principles to interpret statutes,[378] consider and use "equity preemption" and the equity maxim that "equity will not suffer a wrong without a remedy."

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preempt the claims because plaintiffs would not otherwise have a remedy. *See id.* Thereafter, the Sixth Circuit in *Tolton v. American Biodyne, Inc.*, 48 F.3d 937, 943 (6th Cir. 1995), a case involving an alleged denial of medical benefits during utilization review, distinguished *Perry* on the grounds that it did not hold that, in the absence of a remedy under ERISA, ERISA would not preempt a state law claim that was cognizable under ERISA's civil enforcement provision. *See id.* at 943 n.5.

From the above discussion, a logical conclusion is that if plaintiff's state law claim is not cognizable under ERISA's civil enforcement provisions, then ERISA should not preempt the claim if the plaintiff would be left without a remedy for an ERISA administrator's alleged wrongful conduct.

377. *See Tolton*, 48 F.3d at 943 n.5.

378. The general argument against the unfettered use of equitable construction, is that judges, in the guise of statutory interpretation, will engage in judicial lawmaking and therefore apply a statute in such a way as to carry out their own view of what the law should be despite the fact that Congress, if it had thought of the matter, possibly would have had a different intent regarding the statute's application. However, it seems that equitable interpretation is appropriate when a statute's language leaves a gap between its general application and its application in the particular case before the judge. *See* Marcin, *supra* note 30. If the answer can be obtained by looking at legislative history and other aids of statutory interpretation, then courts should rely on such aids and interpret statutes consistently with legislative or congressional intent. When the gap cannot be filled, because interpretative aids are not helpful, then courts should engage in equitable construction by using any means necessary to aid it in determining whether the particular facts of the cases fall within the scope of the statute, especially when there is legislative or other authority supporting judicial lawmaking and equitable construction. Therefore, it is important that Congress has given federal courts the authority to engage in judicial lawmaking through the creation of federal common-law causes of action to fill in the gaps that exist in ERISA's statutory scheme. *See* Pittman, *supra* note 22. However, in respect for federalism and the presumption against the preemption of states' historical regulation of the quality of medical care, courts should defer to state law regulation by avoiding preemption of state law claims through the use of equity preemption when there is otherwise no adequate remedy under ERISA's civil enforcement provisions.

THE NEGLECTED HISTORY OF THE PRIOR RESTRAINT DOCTRINE: REDISCOVERING THE LINK BETWEEN THE FIRST AMENDMENT AND THE SEPARATION OF POWERS

MICHAEL I. MEYERSON*

INTRODUCTION

The prior restraint doctrine is in danger. Once, Oliver Wendell Holmes could declare that the main purpose of the First Amendment was "to prevent all such previous restraints upon publications as had been practiced by other governments."[1] But now, many respected commentators have concluded that the concept of prior restraints marks a "distinction without a difference."[2] The prior restraint doctrine has been termed "so far removed from its historic function, so variously invoked and discrepantly applied, and so often deflective of sound understanding, that it no longer warrants use as an independent category of First Amendment analysis."[3]

One reason for the strong antipathy toward the prior restraint doctrine is that it seems to justify the imposition of subsequent punishments on speech. Ever since Blackstone and the Sedition Act of 1798, the heavy hand of censorship has been defended on the basis that no "previous restraint" is involved.[4] Because the prior restraint doctrine provides no substantive protection, it "leaves open the possibility that this same speech-suppressive activity might be found constitutional if sufficiently redesigned and recast in the form of a subsequent sanction."[5]

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1. Patterson v. Colorado, 205 U.S. 454, 462 (1907) (quoting Commonwealth v. Blanding, 20 Mass. 304, 313 (1825)). *See also* Near v. Minnesota, 283 U.S. 697, 713 (1931) (stating that "it has been generally, if not universally, considered that it is the chief purpose of the [First Amendment's] guaranty to prevent prior restraints upon publication").

2. *See* Marin Scordato, *Distinction Without a Difference: A Reappraisal of the Doctrine of Prior Restraint*, 68 N.C. L. REV. 1 (1989).

3. John Calvin Jeffries, Jr., *Rethinking Prior Restraint*, 92 YALE L.J. 409, 437 (1983). *See also* Note, *Prior Restraint—A Test of Invalidity in Free Speech Cases?*, 49 COLUM. L. REV. 1001, 1006 (1949) ("Whatever the value of the prior restraint doctrine in the past, it has outlived its usefulness.") (citation omitted). Not all commentators are ready to give up on the prior restraint doctrine. *See, e.g.*, Vincent Blasi, *Toward a Theory of Prior Restraint: The Central Linkage*, 66 MINN. L. REV. 11 (1981); Howard Hunter, *Toward a Better Understanding of the Prior Restraint Doctrine: A Reply to Professor Mayton*, 67 CORNELL L. REV. 283, 293-95 (1982).

4. *See infra* text accompanying notes 113-18, 183-87.

5. Scordato, *supra* note 2, at 33. *See also* Hans A. Linde, *Courts and Censorship*, 66 MINN. L. REV. 171, 185 (1981) (stating that subsequent punishment is prior restraint for all practical

Unless we inhabit a legal universe where all speech is protected, though, the doctrine of prior restraints is essential for the protection of free speech. As soon as it is conceded that some speech may be punished, procedural protection becomes essential. With its distinguished historical pedigree, the prior restraint doctrine helps to preserve the murky line between protected and unprotected speech. Even a vigorous defense of protected speech is aided by the secondary shield of the prior restraint doctrine. Moreover, the doctrine serves to restrain the overuse of arguably permissible censorship by biased, over-eager, or insensitive government officials. This protection is only possible, however, if a critical problem is solved: "prior restraint" must be given a usable legal definition.

Many share the frustration of Professor Harry Kalven who bemoaned in 1971, "it is not altogether clear just what a prior restraint is or just what is the matter with it."[6] Without a legal definition, "prior restraint" has frequently degenerated into nothing more than a "category label."[7] It is almost a game for

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purposes because "[i]ts object is to prevent publication, not to impose punishment"); Thomas R. Litwack, *The Doctrine of Prior Restraint*, 12 HARV. C.R.-C.L. L. REV. 519, 521 (1977) (stating that "[t]he threat of criminal and civil penalties can inhibit arguably protected expression from reaching the public just as effectively as injunctions or licensing schemes"); William T. Mayton, *Toward a Theory of First Amendment Process: Injunctions of Speech, Subsequent Punishment, and the Costs of the Prior Restraint Doctrine*, 67 CORNELL L. REV. 245, 276 (1982) (arguing that "subsequent punishment is calculated to suppress, and does indeed suppress, the publication of speech"); Martin H. Redish, *The Proper Role of the Prior Restraint Doctrine in First Amendment Theory*, 70 VA. L. REV. 53, 54 (1984).

A related argument is that the prior restraint doctrine injures free expression, because it encourages subsequent punishments which are more harmful than injunctions. As Professor Scordato argued:

> [B]ecause uniform, impersonal threats, while they may have less of a deterrent effect on any given individual, will have some influence on every individual in the regulated community. On the other hand, specific, personal threats, while perhaps more potent with respect to each targeted individual, are limited in their scope, by definition, to one, or at the most to a very few, such individuals. The overall societal impact of such specific, personal threats, given the large number of individuals in society, is quite small indeed.

Scordato, *supra* note 2, at 14. *See also* Mayton, *supra*, at 246 (stating that "the preference for subsequent punishment over injunctive relief diminishes the exercise of free speech by burdening it with costs that seem not yet comprehended").

This is an intriguing argument, but it relies on the mathematically-unresolvable question of whether a weak threat to many impacts speech more than a strong threat to a few. One problem is that the extent of the different threats is unquantifiable, so comparison of total harm is impossible. Recognizing that both prior restraints and subsequent punishment are harmful to free expression, I prefer to oppose them both, and, if truly forced to choose, prefer the security of the historically-based doctrine of prior restraints.

6. Harry Kalven, Jr., *The Supreme Court, 1970 Term—Foreword: Even When a Nation Is at War*, 85 HARV. L. REV. 3, 32 (1971).

7. Scordato, *supra* note 2, at 10. "[T]he category has been defined in ways that bear no

attorneys defending speakers to try to affix the label "prior restraint" on whatever law is being challenged.[8] And the game can be successful. As Professor Laurence Tribe has noted, the Supreme Court "has often used the cry of 'prior restraints' not as an independent analytical framework but rather to signal conclusions that it has reached on other grounds."[9]

The primary reason that there is currently no generally-accepted legal definition of the prior restraint doctrine comes from the fact that "[t]here exists no comprehensive study of its historical roots."[10] In this Article, I attempt to conduct that comprehensive study.

To examine the history of prior restraints, it is necessary to begin with the English experience, starting from before the Star Chamber and progressing through the American Revolution. Next, the American experience, from colonial times to the drafting of the First Amendment and beyond, needs to be studied. One important discovery I made was a wealth of forgotten Nineteenth Century cases from state courts recognizing and implementing protections against prior restraints as integral components of state constitutional provisions.

What emerges from this historical study is the surprising element that has been missing from the earlier discussions of prior restraints. At its core, the doctrine of prior restraints embodies, not only principles of free speech, but principles of separation of powers as well. Each branch of government is restricted in terms of timing, both in regard to the communication itself and to the actions of the other branches of government. Separation of powers has always been a critical, if indirect, mechanism for preserving individual liberty. As Justice Kennedy remarked, "[l]iberty is always at stake when one or more of the branches seek to transgress the separation of powers."[11] Nowhere is that more true than in the doctrine of prior restraints.

The inclusion of separation of powers principles permits, for the first time, the creation of a complete definition of prior restraints. Once this definition has been given, two facts become clear. First, the doctrine of prior restraints can be easily and consistently applied to a wide range of speech-related issues. Second, it remains of critical importance for the protection of free expression that the prior restraint doctrine be preserved.

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reasonable relation to the common-sense meaning of the category label." *Id.* at 30.

8. First Amendment expert Floyd Abrams once told a symposium that "he was very tempted, as an advocate, to characterize anything having the vaguest semblance to a prior restraint as a prior restraint, since prior restraints are somewhat of a taboo." Donald M. Gillmor, Prologue to Near v. Minnesota *50th Anniversary Symposium*, 66 MINN. L. REV. 1, 8 (1981).

9. LAURENCE H. TRIBE, AMERICAN CONSTITUTIONAL LAW §§ 12-34, at 1040 (2d ed. 1988). *See also* Jeffries, *supra* note 3, at 413 (referring to the "latent plasticities" of the prior restraint doctrine).

10. Thomas I. Emerson, *The Doctrine of Prior Restraint*, 20 LAW & CONTEMP. PROBS. 648, 650 (1955). *See also* Redish, *supra* note 5, at 54 (stating that "apparent doctrinal ambiguities and inconsistencies result from the absence of any detailed judicial analysis of the true rationale behind the prior restraint doctrine").

11. Clinton v. City of New York, 524 U.S. 417, 450 (1998) (Kennedy, J., concurring).

I. THE ENGLISH HERITAGE

A. Licensing Printing

The first printing in England occurred in 1476, and it was not long after that restrictions began to be imposed.[12] Printing posed a new danger to the established regimes. Communication was suddenly possible with many more people. Also, because the words remained permanently affixed, rather than vanishing instantaneously, they served as a perpetual source of potential incitement.

The first official censor was the English Church.[13] In March 1526, a printer, Thomas Berthelet, was brought before the ecclesiastical court. His work was not only unobjectionable, it actually provided nothing more than the text of a bishop's sermon given at, and in support of, a public burning of heretical books. Berthelet's offense was that the printing had occurred before the bishop had been given the opportunity to preview and approve the publication.[14] King Henry VIII gave governmental sanction to this requirement, with a proclamation in June 1530, mandating that no religious book be printed until it had first been "examyned and approued by the ordinary of the diocese."[15]

After the King wrested control of the Church in the early 1530's, protection of the Crown became as high a priority as protection of the faith. In 1538, a new proclamation was issued, Proclamation Antiquity 2 (97), which instituted the first comprehensive licensing system.[16] Religious books were still to be licensed by bishops, but all others needed the approval of members of King Henry VIII's Privy Council.[17] The penalty for unauthorized publication included loss of property, fine, or imprisonment. Printers could also be required to post bond of up to 100 pounds to guarantee their compliance with the law.[18]

In 1546, the rules were modified to speed up the book approval process.[19] Under Proclamation Antiquity 2 (171), licensors were required to decide on the merits of each book within two days of receiving their copy in order to avoid the problem of unlimited delay.[20]

The licensing law was revised again in 1559, one year into the reign of

12. *See* FRED S. SIEBERT, FREEDOM OF THE PRESS IN ENGLAND 1476-1776: THE RISE AND DECLINE OF GOVERNMENT CONTROL 22-23 (1965). The first English printer is believed to have been William Caxton. *See id.* at 22.

13. *See id.* at 42.

14. *See id.* at 43.

15. *Id.* at 46.

16. *See id.* at 48-49.

17. *See id.* at 49.

18. *See id.*

19. *See id.* at 51.

20. *See id.*

Queen Elizabeth.[21] Her royal injunctions required review prior to the publication of all books, pamphlets, plays and ballads, and mandated that the name of the licensor who approved the work "be added in the end of euery such worke, for a testomonie of the alowance thereof."[22]

The next major step in the regulation of printing occurred in 1586, and involved two of the most powerful forces ever created for limiting a free press, the Stationers Company and the Star Chamber.[23] The Stationers Company was the royally-authorized organization of printers and writers. Members of the Stationers Company received special privileges, most notably freedom from competition,[24] and the number of printers was strictly limited. In 1585, the Queen ordered that there should be no printing presses except in London, Oxford and Cambridge, with only one press allowed in each of the two universities.[25] The Company had two primary objectives: 1) protecting the economic interest of its members in limiting the number of printers, and 2) defending the interests of their protector, the Crown.

The Star Chamber has long symbolized the arbitrary and uncontrollable abuse of power both in England and the United States. The Star Chamber served as an unhealthy hybrid of legislature and court, issuing regulations and trying and sentencing those accused of violating its laws. A colonial journalist later described the Star Chamber as

> a Court of which no Friend to his Country can speak without Emotion; and indeed it was such a cruel Engine of Oppression, that it deserves the sharpest Invectives.
>
> It was a Tribunal in which our King antiently presided in Person; and his Assistants were his own Privy Counsellors. Its Name is owing to the Ceiling of the Chamber where it was held, which was garnished with golden Stars; and proceeding without a Jury, well might the *poor Subject* tremble before a Bar where every Circumstance inspired Terror and Confusion. . . .
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> . . . .
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> . . . They heard Witnesses, examined even the accused, and pronounced Judgment both as *Judges and Jurors*.[26]

On June 23, 1586, the Star Chamber issued a decree which regulated every aspect of printing.[27] All printers were required to register their presses with the

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21. *See id.* at 57.

22. *Id.*

23. *See id.* at 69.

24. *See id.* at 68-71.

25. *See* JAMES PATERSON, THE LIBERTY OF THE PRESS, SPEECH, AND PUBLIC WORSHIP 44 n.4 (1880); *see also* WILLIAM PIERCE, AN HISTORICAL INTRODUCTION TO THE MARPRELATE TRACTS 23 (1908).

26. William Smith, *Letter to Printer*, N.Y. GAZETTE; OR WKLY. POST-BOY, Mar. 19, 1770, at number 1420.

27. *See* SIEBERT, *supra* note 12, at 68-74.

Stationers Company and receive a license prior to the publication of any work. The number of printers was strictly limited, with the Archbishop of Canterbury and the Bishop of London empowered to determine how many master printers could be licensed.[28]

The Stationers Company was authorized to search for illegal presses and printed material. The decree permitted the Company "to make search in all workhouses, shops, warehouses of printers, booksellers, bookbinders, or where they shall have reasonable cause of suspicion."[29]

Violators of Company rules could face not only a fine but destruction of printing presses as well. The Company was permitted to order the "defacing, burning, breaking and destroying" of presses and type.[30] A typical case involved Roger Ward, who published an unauthorized book of sermons. In its order, the judicial branch of the Company, the Court of Assistants, detailed the illegal practices of this underground printer: "[H]e did also kepe & conceal a presse and other printing stuff in a Taylors house neere adioyninge to his own house and did hyde his letters in a henhouse neere St Sepulchres churche exp'ssely agt the decrees of the starcha[m]ber."[31] The Court of Assistants ordered that, "all his presses and printinge instruments shalbe defaced & made unserviceable for printing."[32]

The most important defiance of the Star Chamber decree involved the Marprelate Tracts, a set of Puritan pamphlets published between 1588 and 1589. This was not a peaceful period in English history. On May 9, 1588, a large fleet of warships, the Spanish Armada, set sail from Portugal for the English Channel, only to be defeated by bad weather in late August.

A different kind of assault was launched in October 1588, when the first of several tracts was published under the pseudonym, *Martin Marprelate*.[33] This pamphlet, popularly called, *The Epistle*, satirized the existing religious establishment, particularly the Bishops.[34] Even the supposed author's name, marprelate, was a none-too-subtle dig at the Church. Referring to the pamphlet, Winston Churchill wrote: "Their sturdy and youthful invective shows a robust and relishing consciousness of the possibilities of English prose."[35]

It is still not known for certain who authored the Marprelate Tracts, but several players participated in the conspiracy. Robert Waldegrave was a Puritan printer who had previously battled the religious authorities.[36] On April 16, 1588,

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28. *See id.*

29. *Id.* at 84 (quoting Item VI of the Star Chamber Decree of 1586).

30. *Id.* at 85 (quoting Item VII of the Star Chamber Decree of 1586).

31. Order of July 4, 1590. W. GREGG, RECORDS OF THE COURT OF THE STATIONERS' COMPANY 42 (1930).

32. *Id.*

33. *See generally* PIERCE, *supra* note 25, at 148.

34. *See id.* at 148-49.

35. WINSTON S. CHURCHILL, A HISTORY OF THE ENGLISH SPEAKING PEOPLES: THE NEW WORLD 116 (1956).

36. *See* PIERCE, *supra* note 25, at 151.

the Stationers Company broke down the main walls of his house and seized his press and type.[37] Waldegrave was able to leave the house with a box of type hidden "under his cloke."[38] He then set up a secret press at the home of Elizabeth Crane, the widow of Nicholas Crane, a Puritan who had died in Newgate prison a short time before.[39] As the first copies of *The Epistle* left the Kingston area where Crane lived and began circulating throughout the country, the Privy Council ordered that those responsible for its publication be located and arrested.[40] By the time Church officials began questioning residents of Kingston, the press had been moved to a new location in Fawsley. The journey took almost two weeks, as the press, hidden in a cart under straw and hay, bounced along unsafe country roads.[41]

In Fawsley, towards the end of November 1588, the second Marprelate tract, *The Epitome*, was published.[42] Each new publication, with its fresh attack on the Bishops of England, intensified the search for the press. As if to give new meaning to the phrase "movable type," the printing press was continually transported in secret from Fawsley to Norton to Coventry, and then on to the village of Warington.[43] On August 1, 1589, as the press was being unloaded in Warington, some type fell out of its box and spilled onto the ground.[44] Since printing presses were illegal in most of the country, the townspeople had never seen type before and were unable to identify the pieces of metal. One of the Marprelate printers, John Hodgkins, told the crowd which had assembled that "they were shott," but apparently not everyone was convinced.[45] Someone in the crowd picked up a piece of type and was finally able to have it properly identified.[46] On August 14, the local sheriff burst into their home and arrested Hodgkins and two of his assistants, Valentine Simms and Arthur Thomlyn.[47]

The three men were transported to London, where they were sent to the Tower for questioning.[48] At the Tower, the three were placed on the rack and subjected to excruciating torture.[49] All confessed to their parts in the printing of the Marprelate tracts.[50] Before the Star Chamber, Hodgkins argued that the confessions should not be believed because the confessions of Simms and Thomlyn "had bene violent[ly] extorted from them," and his own confession

37. *See id.* at 152.
38. *Id.*
39. *See id.* at 154.
40. *See id.* at 159-60.
41. *See id.* at 178.
42. *See id.* at 178-79.
43. *See id.* at 178-80, 189.
44. *See id.* at 189-90.
45. *Id.* at 190.
46. *See id.*
47. *See id.*
48. *See id.* at 191, 197.
49. *See id.* at 198.
50. *See id.* at 199.

"was forced thereunto by rackinge and great torments."[51] Nonetheless, all three were kept in prison.[52]

Most of the other Marprelate conspirators met similar fates. John Udall, whose earlier writings were the basis of some of the Marprelate publications, died in prison.[53] John Penry, who many suspect of being one of the primary authors of the Marprelate tracts, escaped to Scotland but was hanged for treason on his return to England in 1593.[54]

Licensing of the press continued to serve as the primary, though not exclusive, means for limiting printed opposition to both the crown and church throughout the early Seventeenth Century. A second Star Chamber decree, in 1637, reiterated and expanded the licensing requirement. The difficulty of enforcing these requirements was bemoaned by the Star Chamber itself, which stated that:

> divers abuses have . . . beene practised by the craft and malice of wicked and evill disposed persons, to the prejudice of the publike; And divers libellous, seditious, and mutinous bookes have beene unduly printed, and other bookes and papers without licence, to the disturbance of the peace of the Church and State.[55]

The Star Chamber usually dealt only with those "wicked and evill disposed persons" who had published without prior approval, and the trial of a licensed publisher was cause for great comment.[56] For example, in 1637, William Prynne, with a questionably obtained license, published Calvinist tracts attacking the practices of the Presbyterian church. His trial in the Star Chamber was on charges of seditious libel, that is, impermissible criticism of the government.[57] The rarity of proceeding against a licensed book is illustrated by the lawyer who exclaimed to the Star Chamber, "are none brought but such as are Unlicensed."[58]

The licensor who had granted approval for the offensive work, William Buckner, pleaded in his own defense that Prynne had included unexamined pages

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51. *Id.*

52. *See id.*

53. *See id.* at 214.

54. *See* Wilson, *The Marprelate Controversy*, *in* 3 THE CAMBRIDGE HISTORY OF ENGLISH LITERATURE 383 (1964). It is noteworthy that, as was typical of the earliest proponents of liberty of religion and speech, these early opponents of censorship had only an imperfect appreciation of the concepts of these freedoms. Even the hunted printers of the Marprelate tracts would have denied these rights to those who followed the "Antichristian pope." PIERCE, *supra* note 25, at 194 (quoting THE PROTESTATYON OF MARTIN MARPRELAT 3 (1589)).

55. *Star Chamber Decree of 1637*, *reprinted in* 2 COMPLETE PROSE WORKS OF JOHN MILTON 793 (1959).

56. *Id.*

57. *See* SIEBERT, *supra* note 12, at 124.

58. Philip Hamburger, *The Development of the Law of Seditious Libel and the Control of the Press*, 37 STAN. L. REV. 661, 679 (1985).

along with the licensed work and was fined fifty pounds for his negligence.[59] Prynne was convicted in summary proceedings and sentenced to both a fine and the loss of his ears. The mutilation occurred on a platform in the center of town. The large crowd that watched the proceedings was loudly sympathetic for the victim and visibly antagonistic toward the bishops and Star Chamber.

The end of the unpopular Star Chamber, which occurred on July 5, 1641, did not mean the end to restraints on the press. On June 14, 1643, a new licensing law was enacted.[60] This time, it was the Parliament that was to serve as censor, rather than the Crown. In its order, Parliament noted "the great late abuses and frequent disorders in Printing many false forged, scandalous, seditious, libellous, and unlicensed Papers, Pamphlets, and Books to the great defamation of Religion and government."[61] Parliament also complained that unlicensed printers had begun to "print, vend, publish and disperse Books, pamphlets and papers, in such multitudes, that no industry could be suficient to discover or bring to punishment, all the severell abounding delinquents."[62] Under Parliament's new order, all books and pamphlets had to be approved by licensors appointed by either the House of Commons or the House of Lords.[63]

About this time, intellectuals began to expound on the need for freedom from prior review as an indispensable ingredient for a free society and a free press. In 1644, William Walwyn published an anonymous pamphlet, *The Compassionate Samaritane*, which conceded the appropriateness of penalizing those who attacked the State, but criticized the practice of licensing the press:

> [A]n Ordinance for licensing of Books, which being intended by the Parliament for a good & necessary and (namely) the prohibition of all Bookes dangerous or scandalous to the State, is become by meanes of the Licensers (who are Devines and intend their owne interest) most serviceable to themselves (scandalous Bookes being still dispert) in the stopping of honest men writings, that nothing may come to the Worlds view but what they please, unlesse men whill runne the hazard of imprisonment, (as I now doe) so that in publike they may speake what they will, write what they will, they may abuse whom they will, and nothing can besaid agains them.[64]

A few months later, on November 24, 1644, John Milton published *Areopagitica*.[65] This work has been regarded as one of the first great statements

59. *See* SIEBERT, *supra* note 12, at 145.

60. *See id.* at 186-87.

61. Licensing Order of June 14, 1643, *reprinted in* 2 COMPLETE PROSE WORKS OF JOHN MILTON, *supra* note 55, at 797.

62. *Id.*

63. *See id.*

64. WILLIAM WALWYN, THE COMPASSIONATE SAMARITANE 37-40 (1644), *quoted in* SIEBERT, *supra* note 12, at 194.

65. AREOPAGITICA; A SPEECH OF MR. JOHN MILTON FOR THE LIBERTY OF UNLICENC'D PRINTING, TO THE PARLAMENT OF ENGLAND, *reprinted in* 2 COMPLETE PROSE WORKS OF JOHN

for freedom of expression, though, like the author of the Marprelate tracts, Milton was unwilling to extend his tolerance to "Popery, and open superstition."[66]

Milton was also willing to concede that the Government should be able to penalize offensive speech. If printers published scandalous or seditious work, Milton accepted the premise that the Government should "confine, imprison, and do sharpest justice on them as malefactors."[67] But, licensing, according to Milton, created a special and intolerable harm by preventing books from ever seeing the light of day. Prior to the imposition of licensing:

> Books were ever as freely admitted into the World as any other birth; the issue of the brain was no more stifl'd then the issue of the womb . . . if it prov'd a Monster, who denies, but that it was justly burnt, or sunk into the Sea. But that a Book in wors condition then a peccant soul, should be to stand before a Jury ere it be borne to the World, and undergo yet in darknesse the judgement of *Radamanth* and his Collegues [the mythical judges of Hades], ere it can passe the ferry backward into light, was never heard before . . . .[68]

Another aspect of licensing that haunted Milton was his view that prior suppression of a work robbed humanity of its ideas for all time. Milton said, "who kills a Man kills a reasonable creature, Gods Image; but hee who destroyes a good Booke, kills reason it selfe, kills the Image of God, as it were in the eye[,] . . . slaies an immortality rather then a life."[69]

In spite of the pleas of poets, licensing continued for most of the Seventeenth Century. New laws were passed in 1647 and 1662. The Licensing Act of 1662 both prohibited the publication of seditious and heretical works, and prohibited the publication of books without license by the Stationers' Company.[70] In 1679, the licensing statute expired, but English judges ruled that the Crown could still license even without statutory authority. In a 1680 trial for the crime of publishing a weekly newspaper without a license, the recorder for the court, George Jeffreys, stated that, "[i]t is the opinion of all the judges of England that

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MILTON, *supra* note 55, at 485-570 [hereinafter AREOPAGITICA].

66. *Id.* at 565. *See generally* LEONARD LEVY, EMERGENCE OF A FREE PRESS 93-97 (1985). Despite its limitations, *Areopagitica* provides solid arguments for freedom of expression. Milton proclaimed his belief that open discussion, free from governmental control, would produce "Truth." AREOPAGITICA, *supra* note 65, at 561. In perhaps the most quoted passage, Milton argued:

> And though all the windes of doctrin were let loose to play upon the earth, so Truth be in the field, we do injuriously by licencing and prohibiting to misdoubt her strength. Let her and Falshood grapple; who ever knew Truth put to the wors, in a free and open encounter.

Id.

67. *Id.* at 492.

68. *Id.* at 505-06 (citations omitted).

69. *Id.* at 492-93.

70. *See* PATERSON, *supra* note 25, at 45-46 n.1.

it is the law of the land, that no person should offer to expose to public knowledge any thing that concerns the government, without the king's immediate license."[71]

Parliament, however, was not content to rely on such judicial reasoning, and passed licensing acts in 1685 and again in 1692. The 1692 Act expired by its own terms in 1695. Although the House of Lords voted to renew the law, the House of Commons refused. The reasons given for permitting the licensing law to lapse were far more practical than philosophical.[72] The two main complaints about the licensing system were that it was ineffective in stopping scurrilous books and that poorly paid licensors were frequently bribed by aspiring publishers.

Many printers protested the special privileges and protections of law granted to the favored few. The House of Commons also complained that, while the Licensing Act banned "offensive" works, it supplied no test for offensiveness. Moreover, because the Act did not specify the penalty for violations, judges were free to impose arbitrary and excessive penalties. The House of Commons did not, however, argue that the press should be free to criticize the Government, or even that licensing itself was destructive of freedom. In the words of British historian Lord T.B. Macaulay, "[o]n the great question of principle, on the question whether liberty of unlicensed printing be, on the whole, a blessing or a curse to society, not a word is said."[73]

Despite the uninspired reasoning of Parliament, the expiration of the Licensing Act quickly became perceived as a monumental victory for freedom of the press. In 1701, Daniel Defoe described the "tyranny of a Licenser" as one of the great burdens ever to have been imposed on the press, and credited the English Government with the wisdom to end this evil:

> This, in all Ages, has been a method so ill, so arbitrary and so subjected to bribery and Parties, that the Government has thought fit, in justice to

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71. *The Trial of Henry Carr, or Care, at the Guildhall of London, For a Libel: 32 Charles II. A.D. 1680, in* 7 COBBETT'S COMPLETE COLLECTION OF STATE TRIALS AND PROCEEDINGS FOR HIGH TREASON AND OTHER CRIMES AND MISDEMEANORS FROM THE EARLIEST PERIOD TO THE PRESENT TIME 1111, 1115 (1810). Lord Chief Justice William Scroggs concurred in this statement of the common law of England:

> [T]o print or publish any newsbooks or pamphlets of news whatsoever, is illegal; that it is a manifest intent to the breach of the peace, and they may be proceeded against by law for an illegal thing. Suppose now that this thing is not scandalous, what then? If there had been no reflection in this book at all, yet it is *illicitè*, and the author ought to be convicted for it. And that is for a public notice to all people, and especially printers and booksellers, that they ought to print no book or pamphlet of news whatsoever, *without authority*.

Id. at 1127 (second emphasis added). This case led to the impeachment of Justice Scroggs. *See infra* notes 92-96 and accompanying text.

72. *See* H.L. JOUR., XV, 545-46 (April 18, 1695); *see also* 11 H.C. JOUR. 306 (1695).

73. T.B. MACAULAY, III HISTORY OF ENGLAND 328 (1906).

> the Learned Part of the World, not to suffer it; since it has always been shutting up the Press to one side, and opening it to the other; which, as Affairs are in England often changing, has, in its turn, been oppressive to both.[74]

B. The Distrust of Judges

A second development in the battle for a free press involved the growing consensus in England that judges were a potential source of oppression. Thus, one of the major Eighteenth Century battles for freedom of the press in England was to give jurors, rather than judges, the power to determine whether publications were in fact defamatory. Previously, jurors had been limited to the question of whether the defendant published the material.[75]

The most notorious case of penalizing independent-minded jurors involved the 1670 English trial of William Penn, later the founder and first Governor of Pennsylvania. Penn had been charged with violating the Conventicle Act, which prohibited the exercise of religion "in other manner than according to the liturgy of the Church of England."[76] Penn, a Quaker, had been preaching on a London street corner, and there was no denying that such preaching had occurred.[77] During Penn's trial, the court told the jury to ignore the defendant's plea for acquittal based on freedom of conscience. The court recorder instructed the jury that witnesses had testified to the fact of the preaching and that they were "to keep and to observe, as what hath been fully sworn, *at your peril*."[78] From the bale-dock, a prison-like cylindrical structure in the corner of the courtroom where he had been placed, Penn cried out, "I appeal to the jury, who are my judges, and this great assembly, whether the proceedings of the court are not most arbitrary, and void of all law, in offering to give the jury their charge in the absence of the prisoners."[79]

The jury refused to hand down a guilty verdict.[80] Led by jurymember, Edward Bushel, the jury found Penn guilty of "preaching," but pointedly omitted any reference to guilt of unlawful preaching.[81] The Recorder responded to the jury:

> Gentlemen, . . . you shall not be dismissed, till we have a verdict that the

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74. DANIEL DEFOE, THE TRUE BORN ENGLISHMAN (1703), *reprinted in* LATER STUART TRACTS 110 (1964).

75. This controversy was finally resolved by statute in 1792, when Fox's Act, 1792, 32 Geo. 3 c. 60, declared that juries may give a general verdict of guilty or not guilty on libel.

76. CATHERINE OWENS PEARE, WILLIAM PENN, A BIOGRAPHY 106-07 (1956) (quoting the Conventicle Act).

77. *See id.* at 109-10.

78. *Id.* at 118.

79. *Id.*

80. *See id.* at 119-22.

81. *Id.* at 120.

> court will accept; and you shall be locked up, without meat, drink, fire and tobacco. You shall not think thus to abuse the court. We will have a verdict by the help of God, or you shall starve for it.[82]

The next day, the jury announced the verdict that "William Penn is guilty of speaking in Gracious Street," again refusing to term it unlawful.[83] After more threats by the court, William Penn said, "[i]t is intolerable that my jury should be thus menanced . . . . What hope is there of ever having justice done, when juries are threatened, and their verdicts rejected?"[84] The next morning, the jury announced that Penn was "not guilty."[85] Upon hearing the verdict, the Recorder stated, "'I am sorry, gentlemen, you have followed your own judgment and opinions rather than the good and wholesome advice which was given you.'"[86]

All twelve members of the jury were fined and sent to Newgate prison until they paid.[87] Eight paid rather quickly, but four, Edward Bushel, John Hammond, Charles Milson and John Baily, refused and stayed in prison for several months. Finally, the Court of Common Pleas ruled that jurors could not be penalized for such conduct: "It is absurd, a jury should be fined by the judge for going against their evidence . . . ."[88]

More than a century later, American colonists would recite this case as an example of the need for juries to protect liberty against the overreaching of the Crown's judges. One colonial writer referred to the much respected William Penn as "the same to whom we owe one of the freest and fairest of our Colonies,"[89] and analogized his case to colonial trials for seditious libels, where juries were denied the right to determine the validity of printed complaints against the government. The obvious lesson for colonial libertarians was that juries were forever to be viewed as a "Bulwark of Saftey against Pride, Insolence and Partiality of Power."[90]

In 1680, ten years after the trial of William Penn, Lord Chief Justice William Scroggs was impeached for his abuse of judicial authority.[91] Under Scroggs' rulings, the House of Commons declared, "all the mischiefs and excesses of the

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82. *Id.*

83. *Id.* at 121.

84. *Id.*

85. *Id.* at 122.

86. SYDNEY GEORGE FISHER, THE TRUE WILLIAM PENN 145 (1899).

87. *See* PEARE, *supra* note 76, at 123.

88. *Id.* at 124.

89. Smith, *supra* note 26, at 1420.

90. *Id.* For a more modern judicial tribute to William Penn's jurors, see *Commonwealth v. Contakos*, 453 A.2d 578, 580-82 (Pa. 1982).

91. *See generally Proceedings Against Lord Chief Justice Scroggs Before the Privy Council; and Against the Said Lord Chief Justice and Other Judges in Parliament: 32 Charles II. A.D. 1680*, *in* 8 COBBETT'S COMPLETE COLLECTION OF STATE TRIALS AND PROCEEDINGS FOR HIGH TREASON AND OTHER CRIMES AND MISDEMEANORS FROM THE EARLIEST PERIOD TO THE PRESENT TIME, *supra* note 71, at 63 [hereinafter *Proceedings Against Lord Chief Justice Scroggs*].

court of Star-Chamber, by act of parliament suppressed, have been again, in direct opposition of the said law, introduced."[92]

The House of Commons highlighted the case of Henry Carr, which Chief Justice Scroggs had presided over earlier that same year.[93] Carr published a periodical entitled, *The Weekly Pacquet of Advice from Rome, or, the History of Popery*.[94] According to one of the Articles of Impeachment voted by the House of Commons, Chief Justice Scroggs, "before any legal conviction of the said Carr of any crime, did . . . in a most illegal and arbitrary manner, make, and cause to be entered, a certain rule of that court against the printing of the said [periodical]."[95] In one of the first official pronouncements against what was to later become termed "prior restraints," the House of Commons voted that the Chief Justice's ruling was "most apparently contrary to all justice, in condemning not only what had been written without hearing the parties, *but also all that might for the future be written on that subject*."[96]

The principle behind favoring jurors, in these cases, over judges was explained by Lord Camden:

> Who shall have the care of the liberty of the press—the judges or the people of England? The jury are the people of England. The judges are independent men! Be it so. But are they totally beyond the possibility of corruption from the Crown? Is it impossible to show them favour in any way whatever? The truth is, they possibly may be corrupted—juries never can! What would be the effect of giving judges the whole control of the press? Nothing would appear that could be disagreeable to the Government.[97]

C. *Refusal to Enjoin Defamatory Statements*

The third strand in the development of the doctrine of prior restraints is found in the well-known maxim that "equity will not enjoin a libel." The history of defamation law reveals that in England, at the time the First Amendment was

92. *Id.* at 199.

93. *See id.* at 198-99.

94. *Id.* at 198. This publication was opposed to the "superstitions and cheats of the church of Rome," and the House of Commons took Chief Justice Scroggs's suppression of it to be proof of the Chief Justice's "manifest countenancing of popery." *Id.*

95. *Id.* The Articles of Impeachment refer to the weekly publication as a "book," but it would more properly be regarded as a "periodical" today. *See, e.g.*, JOHN TOWNSHEND, A TREATISE ON THE WRONGS CALLED SLANDER AND LIBEL AND ON THE REMEDY BY CIVIL ACTION FOR THOSE WRONGS 688 (4th ed. 1890).

96. *Proceedings Against Lord Chief Justice Scroggs*, *supra* note 91, at 198 (emphasis added). The judicial order banning future publication was also seen as a violation of principles of separation of powers. The House of Commons also voted that the order constituted "an encroachment and assuming to [the Court] a legislative power and authority." *Id.* at 199.

97. PATERSON, *supra* note 25, at 221 n.6.

ratified, libel was an offense that could only be punished, but could not be prevented.

There were several different roots to the English law of defamation. During the Thirteenth and Fourteenth Centuries, defamatory statements were generally considered to be matters for religious tribunals, and the ecclesiastical courts heard many cases involving imputations of crimes and sexual immorality.[98] The penalties for defamation included a public request for forgiveness and excommunication.[99]

By the end of the Fifteenth Century, complaints against defamation were heard in two different courts, the Star Chamber and the common-law courts. Early in the 1600s, the Star Chamber declared that libel was a criminal offense because it tended to cause breaches of the peace, and if the libel was "against a magistrate, or other public person, it is a greater offence."[100] Sir Edward Coke, who authored the opinion, added that anonymous libels, which of course meant that they were unlicensed, were particularly egregious and "ought to be severely punished."[101] The Star Chamber's penalties for those found guilty of libel were harsh:

> [A] libeller shall be punished either by indictment at the common law, or by bill, if he deny it, or *ore tenus* on his confession in the Star Chamber, and according to the quality of the offence he may be punished by fine or imprisonment, and if the case be exorbitant, by pillory and loss of his ears . . . .[102]

Moreover, there was no possible protection from a jury of one's peers. The Star Chamber ruled alone on both questions of law and fact.[103]

About this same time, the common-law courts were wresting jurisdiction away from the ecclesiastical courts and claiming jurisdiction over defamations which caused "temporal damages."[104] Thus private persons who wanted to obtain

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98. The local courts also heard complaints about insulting statements through the 14th century. *See, e.g.*, R.C. Donnelly, *History of Defamation*, 1949 WIS. L. REV. 99, 100-03.

99. *See generally* SELECT CASES ON DEFAMATION TO 1600, at xiv-xx (R.H. Helmholz ed., 1985).

100. Van Vechten Veeder, *The History and Theory of the Law of Defamation*, 3 COLUM. L. REV. 546, 565 (1903) (quoting De Libellis Famois, 5 Co. Rep. 125 (1606)). This ruling actually represented an expansion of the Star Chamber's jurisdiction to prosecute those who violated the statutes involving *scandalum-magnatum*. This literally means "scandal of magnates," but generally included attacks against the King or others high in the government. Dueling was a major concern of the Star Chamber, and the belief was that punishing defamation was one way to prevent private demands for retribution. *See id.*

101. *Id.*

102. *Id.*

103. *See, e.g.*, 2 JAMES FITZJAMES STEPHEN, A HISTORY OF THE CRIMINAL LAW OF ENGLAND 308-09 (1883).

104. William L. Prosser, *Libel Per Quod*, 46 VA. L. REV. 839, 841 (1960). At first, the common law courts merely claimed jurisdiction over any defamatory statement that "touches or

damages for a defamatory statement quickly turned to the common-law courts. Because the Star Chamber heard claims of criminal libel and printed defamation, the common-law courts were left mostly with spoken private defamation.

When the Star Chamber was abolished in 1641, the common-law courts assumed its former jurisdiction over defamation, though the rules governing the different forms of defamation were never well-integrated. In 1670, the court formalized the division between libel, or written defamation, and slander, which is spoken.[105]

As licensing of the press continued through 1694, the doctrine of common-law defamation developed relatively slowly. After all, most printed defamatory statements never saw the light of day. In the 1700s, absent the power to license, the English Government often attacked its critics with criminal actions for seditious libels. These were heard in the common-law courts, which also claimed exclusive power to hear private libels.

The courts of equity, accordingly, were denied authority to hear claims for defamation. As early as 1742, it was ruled in the *St. James's Evening Post Case*, that the courts of equity had no jurisdiction over claims of libel and slander: "For whether it is a libel against the publick or private persons, the only method is to proceed at law."[106] Since the common-law courts then had no power at all to grant injunctions, the resultant ruling meant that, in England, defamation could not be enjoined; the only permissible remedy was money damages at law.

Eventually, the inability of equity courts to enjoin libel became considered an integral part of a free press. While a few cases implied that equity could, in fact, enjoin a libellous publication,[107] these cases were quickly dismissed as aberrational throwbacks to a discredited era. For example, it was reported that the very contention that injunctions could in fact be granted to prevent libel "excited great astonishment in the minds of all the practitioners of the courts of equity."[108] According to the court reporter in *Horne's Case*, this surprise was due to the fact that

> there is not to be found in the books any decision or any dictum, posterior to the days of the Star Chamber, from which such doctrine can be deduced, either directly, or by inference or analogy: unless indeed we are to except the proceedings of . . . Scroggs and his associates, in the

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concerns anything determinable at the common law." Palmer v. Thorpe, K.B., Trin. Term, 25 Eliz. [1583], Coke's Rep., Vol. 2, p. 315, part 4, p. 20. This meant imputations of crimes, for example, were heard in common-law rather than ecclesiastical courts.

105. *See* The King v. Lake, Hardes 470 (1670), *cited in* Veeder, *supra* note 100, at 569-70.

106. Roach v. Garvan, 26 Eng. Rep. 683, 683 (1742). This case was popularly known as the *St. James's Evening Post Case*. This case was hardly a complete victory for freedom of the press. The court held that equity had jurisdictions over contempt of court, and the printers were "committed to the *Fleet*." *Id.* at 685.

107. *See* DuBost v. Beresford, 2 Camp. 511-12 (1810) (Chief Lord Ellenborough); Burnett v. Chetwood, 2 Mer. 441 (1720) (Lord Macclesfield).

108. Horne's Case, 20 Howell's State Trials 651, 799 (1777).

case of *Henry Care*.[109]

The 1848 case of *Clark v. Freeman* announced a similar linkage of the concept of enjoining libels to the censorial practices of the past.[110] In rejecting a plea to enjoin the publication of defamatory statements that alleged that a physician to the Queen, "is somehow concerned in vending quack medicines," the court stated, "I am afraid that if I were to interfere as is now asked, I should be reviving the criminal jurisdiction of the Star Chamber."[111]

Thus, an extraordinarily important rule was created more as an offshoot of a jurisdictional dispute than as a calculated understanding of the needs of a free press. In fact, the creation of the rule that equity will not enjoin a libel parallels the almost anti-climatic ending of licensing of the press. These were both "historical accidents"[112] that became understood as invaluable steps along the road to liberty of the press.

D. Understanding England's Liberty of the Press

By the time the United States ratified the First Amendment, a consensus had developed in England that liberty of the press required the ability to put forth to the world what one wanted, as long as the printer was willing to accept the consequences of punishment for material considered illegal. No administrative licensor or censor could preview work prior to publication, and no judicial orders could prevent what could be written for the future.

This background provides context for Sir William Blackstone's famous description of liberty of the press. In his *Commentaries on the Laws of England*, Blackstone described why punishment for libels was consistent with liberty of the press:

> The liberty of the press is indeed essential to the nature of a free state: but this consists in laying no *previous* restraints upon publications, and not in freedom from censure for criminal matter when published. Every freeman has an undoubted right to lay what sentiments he pleases before the public: to forbid this is to destroy the freedom of the press: but if he publishes what is improper, mischievous, or illegal, he must take the

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109. *Id.* In 1861, Lord Cambell discussed the cases of *Burnett v. Chetwood*, 2 Mer. 441 (1720), and *DuBost v. Beresford*, 2 Camp. 511 (1810), and declared, "I have no hesitation in saying that Lord Macclesfield was wrong . . . . [and] that Lord Ellenborough was wrong." Emperor of Austria v. Day & Kossuth, 3 De. G.F. & F. 217, 239 (1861).

110. 11 Beav. 112 (1848) (Lord Langdale, Master of Rolls).

111. *Id.* at 117-18. For other early cases holding that equity lacked jurisdiction to enjoin libels, see *Prudential Assurance Co. v. Knott*, 10 Law Rep. 142 (1875); *Seeley v. Fisher*, 11 Sim. 581 (1841); *Martin v. Wright*, 6 Sim. 297 (1833); *Gee v. Pritchard*, 2 Swanston 428 (1818). *See generally* W. BLAKE ODGERS, THE LAW OF LIBEL AND SLANDER 334-37 (2d ed. 1887).

112. *See, e.g.*, Veeder, *supra* note 100, at 571 ("The process of attempting to give a rational or scientific basis to legal rules which have their origin in historical accidents is familiar to students of English law; the law of defamation has been its favorite field.").

consequences of his own temerity.[113]

Although this statement indicates the general English opposition to "previous restraints," it does not actually say what constitutes such a restraint.[114] Blackstone merely contrasts previous restraints with punishments that are imposed after someone "publishes what is improper, mischievous, or illegal."[115] Later in this same section, Blackstone discusses the licensing of the previous century, but again does not purport to catalog the full array of impermissible previous restraints, but simply contrasts such a restraint with a subsequent punishment.[116]

Thus, Blackstone did not discuss, one way or another, the extent to which judicial orders could be viewed as previous restraints.[117] Significantly, Blackstone's description of the remedy for a libel omits any reference to preventive relief: "The punishment of such libellers, for either making, repeating, printing, or publishing the libel, is fine, and such corporal punishment as the court in its discretion shall inflict; regarding the quantity of the offence, and the quality of the offender."[118]

The lesson from Blackstone is simply that previous restraints, such as licensing, violate liberty of the press. We must turn elsewhere for a fuller description of what was encompassed by the term "previous restraint."

Ten years after Blackstone's *Commentaries* appeared, another author gave an improved description. In 1775, on the dawn of the American Revolution, Jean DeLolme wrote his work, *The Constitution of England*.[119] DeLolme was a Swiss author whose description of the English government, while largely unknown to 20th Century Americans, was well-known and well-respected by Americans at the start of the Republic. John Adams referred to DeLolme's books as "the best defence of the political balance of three powers that ever was written."[120] At the beginning of the Revolution, many American pamphleteers cited Montesquieu

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113. 4 WILLIAM BLACKSTONE, COMMENTARIES *151-52 (1979).

114. *See id.*

115. *Id.* at 152.

116. *See id.* at *152-53. Blackstone also wrote:

> To subject the press to the restrictive power of a licensor, as was formerly done, both before and since the revolution, is to subject all freedom of sentiment to the prejudices of one man, and make him the arbitrary and infallible judge of all controverted points in learning, religion, and government. But to punish (as the law does at present) any dangerous or offensive writings, which, *when published*, shall on a fair and impartial trial be adjudged of a pernicious tendency, is necessary for the preservation of peace and good order . . . .

Id. at *152 (emphasis added).

117. *See id.* at *151-53.

118. *Id.* at *151.

119. JEAN DELOLME, THE CONSTITUTION OF ENGLAND 254 (John MacGregor ed. 1853) (1775).

120. GORDON S. WOOD, THE CREATION OF THE AMERICAN REPUBLIC 575 (1969).

and later DeLolme on the "character of British liberty and on the institutional requirements for its attainment."[121] DeLolme's book was also cited by America's Blackstone, St. George Tucker;[122] Justice Joseph Story, the first great writer on the American Constitution;[123] and, eventually the U.S. Supreme Court.[124]

DeLolme's description of liberty of the press in England stressed that such liberty meant freedom from all previous restraint, whether from the judicial branch or from licensors: "Liberty of the press consists in this: that neither courts of justice, nor any judges whatever, are authorized to take notice of writings intended for the press; but are confined to those which are actually printed."[125]

Thus, at the time of the drafting of the First Amendment, the English understanding of a free press meant, at a minimum, that neither judges nor administrators were to take notice of writings intended for the press. Battles over the permissibility of subsequent punishments persisted over the next two hundred years. But even in a repressive environment that permitted punishment for truthful criticism of the Government,[126] one element of liberty of the press was well-understood: no governmental official—not licensor, not censor, not judge—should be involved in restricting expression before it is communicated.

II. The American Experience

There is an unfortunate tendency among many who study freedom of expression in America to assume that all relevant jurisprudence begins with World War I and that the doctrine of prior restraints emerges out of thin air after two centuries of dormancy with the 1931 case of *Near v. Minnesota ex rel. Olson*.[127] The reality is that by the time the U.S. Supreme Court struck down Minnesota's "Gag Law," there was a wealth of legal tradition and judicial decisions supporting a constitutional ban on prior restraints.

There is no doubt that the Supreme Court itself was a fallow source of

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121. BERNARD BAILYN, THE IDEOLOGICAL ORIGINS OF THE AMERICAN REVOLUTION 27 (1967). English Prime Minister Benjamin Disraeli later described DeLolme as "England's Montesquieu." *See* JOYCE MALCOLM, TO KEEP AND BEAR ARMS 166 (1994).

122. *See* ST. GEORGE TUCKER, BLACKSTONE'S COMMENTARIES 1 app. at 298-99 (1803).

123. *See* 3 JOSEPH STORY, COMMENTARIES ON THE CONSTITUTION OF THE UNITED STATES § 1878-79, at 735-37 (1833).

124. *See* Near v. Minnesota, 283 U.S. 697, 714 n.4 (1931).

125. DELOLME, *supra* note 119.

126. Blackstone wrote approvingly of jailing writers for criticizing the government or its magistrates, even if their charge be true, "since the provocation, and not the falsity, is the thing to be punished criminally." *See* BLACKSTONE, *supra* note 113, at *150.

127. 283 U.S. 697 (1931). *See, e.g.*, DAVID M. RABBAN, FREE SPEECH IN ITS FORGOTTEN YEARS 129 (1997) (stating that "no major casebook on constitutional law includes a single decision before 1917 in its section on freedom of expression"); *see also* Alexis J. Anderson, *The Formative Period of First Amendment Theory, 1870-1915*, 24 AM. J. LEGAL HIST. 56 (1980).

protection for First Amendment freedoms until 1931.[128] For example, in 1897, the Court noted that a city could bar public speaking in a public park, just as "the owner of a private house [could] forbid it in his house."[129] Similarly, the U.S. Post Office's claim to censorial power over the mails was upheld as simply the right of Congress "to refuse its facilities for the distribution of matter deemed injurious to the public morals."[130]

With the Federal constitutional guarantee of freedom of expression viewed as a hollow promise, speakers turned to the state courts for protection of free speech rights guaranteed by state constitutions. Although many state decisions were unfavorable to speakers, one topic represented a notable exception: many state courts struck down governmental action that was perceived to be a "prior restraint."[131]

Such solicitude should not be surprising, considering the history of free expression which preceded the American Revolution. From the very beginning of the legal debate over the true meaning of America's freedom of expression, there has been a powerful consensus that the starting point for such freedom is a ban on prior restraints. Liberty of the press, as the Massachusetts Supreme Judicial Court declared in 1825, "was intended to prevent *all such previous restraints upon publications as had been practised* by other governments, and in early times here, to stifle the efforts of patriots towards enlightening their fellow subjects upon their rights and the duties of rulers."[132]

A. The Road to the First Amendment

In the American colonies, the concept of freedom of the press began slowly, but eventually evolved into a treasured ideal worth fighting for. The colonial experience taught that assaults on liberty of the press could come from any of the three branches of government: the legislative, executive, or judicial.

During the Seventeenth Century, colonial governments followed the English example and used licensing laws to restrict printed material. In 1668, a pamphlet written by Thomas à Kempis was approved by the official censor but then banned by the Massachusetts Bay Colony Governor because Kempis was a "popish

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128. *See, e.g.*, RABBAN, *supra* note 127, at 131 (stating that between the Civil War and World War I, "[n]o court was more unsympathetic to freedom of expression than the Supreme Court, which rarely produced even a dissenting opinion in a First Amendment case").

129. Davis v. Massachusetts, 167 U.S. 43, 47 (1897).

130. *Ex parte* Jackson, 96 U.S. 727, 736 (1877). The Court was also insensitive to the free speech issues inherent in its contempt cases. *See, e.g.*, Toledo Newspaper Co. v. United States, 247 U.S. 402 (1918), *overruled in part by* Nye v. United States, 313 U.S. 33 (1941); Patterson v. Colorado, 205 U.S. 454 (1907).

131. *See generally* David M. Rabban, *The First Amendment in Its Forgotten Years*, 90 YALE L.J. 514, 543 (1981) (noting that although many of the state decisions were counter to free speech, some provide significantly more protection than any decision made by the U.S. Supreme Court).

132. Commonwealth v. Blanding, 20 Mass. (3 Pick.) 304, 313-14 (1825) (emphasis added).

minister."[133] In Virginia, John Bucknew was imprisoned for printing without authority in 1682.[134]

The first newspaper in the colonies was published in Boston on September 25, 1690 and was entitled *Publick Occurrences Both Forreign and Domestick*.[135] Although the publisher, Benjamin Harris, had stated that the paper was to be "furnished once a month (or if any Glut of Occurrences happen, oftener)," the paper lasted only one issue.[136] Harris had criticized the Maqua tribe, allies of the English in the French and Indian Wars, because they "brought home several Prisoners, whom they used in a manner too barbarous for any *English* to approve."[137] The Massachusetts Governor and legislature were angered both by the hint of journalistic disapproval and by the fact that the publication was issued without license.[138] Four days later, noting that the paper contained "reflections of a very high nature," the Legislature voted to forbid, "any thing in print, without license first obtained from those appointed by the government to grant the same."[139] Harris published no further issues of the newspapers and apparently learned to get along with those in power, as he was appointed "Printer to His Excellency the Governor and Council" in 1692.[140]

After the demise of *Publick Occurrences*, the colonies waited more than thirty years for a truly independent newspaper.[141] On August 7, 1721, *The New-England Courant* began in Boston,[142] and it did not take long for the established powers of church and state to be offended. In the first issue, the *Courant* attacked the giant of colonial religion, Cotton Mather.[143] Unfortunately for those who prefer to think of the press as the source of enlightenment, the *Courant* chose the wrong side in the debate over how to deal with the raging smallpox epidemic.[144] The paper condemned Mather for his endorsement of "the *doubtful* and *dangerous* Practice of inoculating the *Small-Pox*."[145]

Most of the other crusades carried on by the *Courant* were not so problematic. Religious hypocrisy and governmental incompetence were frequent targets. The acute sensitivity of those in power to any form of criticism can be

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133. WALTER BRASCH & DANA ULLOTH, THE PRESS AND THE STATE 50 (1986).

134. *See id.*

135. *See* FRANK LUTHER MOTT, AMERICAN JOURNALISM, A HISTORY: 1690-1960, at 9-10 (3d ed. 1962).

136. *Id.* The entire issue of *Publick Occurrence* is reprinted in FREDERIC HUDSON, JOURNALISM IN THE UNITED STATES FROM 1690-1872, at 44-48 (Scholarly Press 1968) (1873).

137. HUDSON, *supra* note 136, at 46.

138. *See* MOTT, *supra* note 135, at 9.

139. HUDSON, *supra* note 136, at 48.

140. *See id.* at 49.

141. *See generally* ARTHUR BERNON TOURTELLOT, BENJAMIN FRANKLIN: THE SHAPING OF GENIUS 232 (1977).

142. *See id.*

143. *See id.* at 234.

144. The smallpox epidemic afflicted 6000 of Boston's population of 10,500. *See id.* at 240.

145. NEW ENG. COURANT, No. 3, Aug. 14-21, 1721.

seen in the reaction to the paper's story on the problem of pirate ships. After two pirate vessels were spotted off the Atlantic coast, the *Courant* reported, "[w]e are advis'd from Boston, that the Government of the Massachusetts are fitting out a Ship to go after the Pirates, to be commanded by Capt. Peter Papillion, and 'tis thought he will sail sometime this Month, if Wind and Weather permit."[146] A modern reader might search these words long and hard for the language which constituted, in the findings of the Governor's Council, "a high affront to this Government."[147] Apparently, the paper was implying that the Government was not acting quickly enough in fighting the pirates.

On June 12, 1721, the day after the issue of the paper containing this dubious criticism had been distributed, the Massachusetts' House of Representatives voted to place the printer of the *Courant*, James Franklin, in jail for the duration of the legislative session.[148] This sentence was imposed without benefit of grand jury indictment or trial; it was simply a unilateral act of the legislature. The printer was placed in a dungeon at the Queen Street jail and after becoming ill, was allowed to go to the prison yard. On July 2, shortly before the end of the prison term, a letter was published in the *Courant* declaring defiantly, "we can easily soar above the little Vulgar, and look down on those who reproach us, with Pity and Courage."[149]

When the paper continued its criticism of those in power, the House of Representatives responded with paradigmatic prior restraint. A special committee was created on January 14, 1723, to recommend the appropriate way to deal with the paper. One of the Committee members was the Chief Justice of the Province, Judge Samuel Sewall, who had helped pursue witches one-quarter of a century earlier in Salem. The Committee took all of one day considering the problem of the *Courant*, reporting its findings on January 15:

> The Committee appointed to Consider the Paper Called the New England Courant published Monday the 14t Currt: are humbly of opinion, That the Tendancy of the Said paper is to Mock Religion, & bring it into Contempt, That the Holy Scriptures are therein prophanely abused, that the Revrd and faithful Ministers of the Gospell are Injuriously Reflected upon, his Magesties Government affronted, and the peace & Good Order of his Majesties Subjects of this Province disturbed by the Said Courant, and for prevention of the like offense for the future, *-The Committee Humbly propose that James Franklyn the Printer & Publisher thereof be Strictly forbidden, by this Court [the House of Representatives], to print, or publish the New England Courant, or any Pamphlet or paper of like Nature, Except it be first Supervised, by the Secretary of this Province. . . .*[150]

146. NEW ENG. COURANT, No. 45, June 4-11, 1722.

147. Journals of the House of Representatives of Massachusetts, IV, 23 (1722).

148. *See id.*

149. NEW ENG. COURANT, No. 48, June 25-July 2, 1722.

150. General Court Records, XI, 493 (emphasis added).

The next day, January 15, 1723, the House approved the Committee's recommendation. James Franklin was thus prohibited from printing not only the *Courant* but any other publication, without it first being reviewed and approved by the government. Again, no court proceedings were necessary for this sanction.

The next few issues of the *Courant* were published with its printer in hiding. The first such issue used the Bible, quoting Psalm 58, in an unsubtle attack on Judge Sewall:

> Have ye forgot or never knew
> That God will judge the Judges, too?
> High in the Heavens his Justice Reigns;
> Yet you invade the Rights of God,
> And send your bold Decrees abroad
> To bind the Conscience in your Chains.[151]

Two weeks later, the *Courant* published the following anonymous open letter to Judge Sewall, pleading for the use of jury proceedings, rather than summary governmental action:

> The end of Humane Law is to fix the boundaries within which Men ought to keep themselves; But if any are so hardy and presumptuous as to break through them, doubtless they deserve punishment. Now if this *Printer* had transgress'd any Law, he ought to have been presented by a Grand Jury, and a fair tryal brought on.[152]

Finally, the pressure of living in hiding, as well the risk of another prison term, convinced James Franklin to try a new approach. Because the restrictive order only applied to him personally, a decision was made to continue printing the *Courant* but with a new publisher. The position was filled by an apprentice at the paper, James's seventeen-year-old brother. On February 11, 1723, the *Courant* appeared with its new imprint: "Boston, Printed and Sold by *Benjamin Franklin,* at his Printing-House in Queen Street, where Advertisements and Letters are taken in . . . ."[153]

Other colonists realized the danger posed by the requirement of prior review of newspapers. Pennsylvania's only newspaper, the *American Weekly Mercury*, ended an attack on the treatment of James Franklin with the following fictitious caustic item: "By private Letters from Boston we are informed, that Bakers there are under great Apprehension of being forbid baking any more Bread, unless they will submit to the Secretary as Supervisor General and Weigher of the Dough, before it is baked into Bread, and offered to Sale."[154]

The Massachusetts' legislature was not the only colonial legislature to seek

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151. NEW ENG. COURANT, No. 77, Jan. 14-28, 1723.
152. NEW ENG. COURANT, No. 79, Jan. 28-Feb. 4, 1723.
153. NEW ENG. COURANT, No. 80, Feb. 4-11, 1723.
154. AMERICAN WKLY. MERCURY, Feb. 26, 1723.

to suppress criticism directly. One historian has counted at least twenty instances before 1776 where authors or printers were brought before a house of a colonial legislature to answer for their statements.[155]

Of course, colonial Americans knew that the Executive, whether King or Governor, could well act alone to repress a free press. In 1747, for example, Governor George Clinton of New York fought with that state's Assembly.[156] After the governor criticized the Assembly for insufficient funding for the military, the Assembly prepared a remonstrance against the Governor. Governor Clinton then ordered James Parker, the official printer for the Assembly and editor of *Weekly Post Boy*, not to publish the remonstrance.[157] The Assembly voted unanimously that the remonstrance should be printed, stating that "his Excellency's Order to forbid the printing or re-printing the said Remonstrance is unwarrantable, arbitrary and illegal," and that publication was necessary to demonstrate the Assembly's "firm Resolution to preserve the Liberty of the Press."[158]

The trial of John Peter Zenger in 1735 highlighted the colonial distrust of judicial oversight of the press.[159] Zenger's newspaper, the *New York Weekly Journal*, had been a leading proponent for a vigorous free press since it was first published on November 5, 1733. One of its initial issues contained an essay detailing the logic behind opposition to governmental censorship:

> If Men in Power were always Men of Integrity, we might venture to trust them with the Direction of the Press, and there would be no Occasion to plead against the Restraint of it; but as they have Vices like their fellows, so it very often happens that the best intended and the most valuable Writings are Objects of their Resentment, because opposite to their own Tempers or Designs.[160]

The *Weekly Journal* also published criticism of government officials, and Zenger was put on trial for seditious libel on August 4, 1735. The judge in the case, Chief Justice James DeLancey, ruled that under English common law the truth was not a defense,[161] and it was for the judge to determine if a printed

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155. *See* JEFFERY A. SMITH, PRINTERS AND PRESS FREEDOM: THE IDEOLOGY OF EARLY AMERICAN JOURNALISM 83 (1988).

156. *See* Jeffrey A. Smith, *A Reappraisal of Legislative Privilege and American Colonial Journalism*, 61 JOURNALISM Q. 97, 100-101 (1984); *see also* LEVY, *supra* note 66, at 45-46.

157. *See* LEVY, *supra* note 66, at 45; Smith, *supra* note 156, at 100.

158. 1 JOURNAL OF THE VOTES AND PROCEEDINGS OF THE GENERAL ASSEMBLY OF THE COLONY OF NEW YORK 671-72 (1766); 2 JOURNAL OF THE VOTES AND PROCEEDINGS OF THE GENERAL ASSEMBLY OF THE COLONY OF NEW YORK 191-93, 198 (1766). Leonard Levy has pointed out that the New York Assembly was more than a little hypocritical, as it felt free to imprison printers whose writings criticized the Assembly. *See* LEVY, *supra* note 66, at 46-47.

159. *See* SMITH, *supra* note 155, at 83 ("Court trials for seditious libel were seldom attempted in America between the Zenger case in 1735 and the Sedition Act of 1798.").

160. James Alexander, N.Y. WKLY. J., Nov. 19, 1733.

161. *See* FREEDOM OF THE PRESS FROM ZENGER TO JEFFERSON 47 (Leonard W. Levy ed.,

statement "make a Lybel" against the government.[162] The sole job of the jury was to decide if the accused had printed the material before the court.[163] Zenger's attorney, Andrew Hamilton, conceded that Zenger had published the material,[164] but argued both that the making of a truthful charge should not be a crime[165] and that the jury, not the judge, should decide whether a statement is libelous.[166] He explained his distrust of the judiciary's deciding on the criminality of those who complain against the government:

> I think it will be agreed, That ever since the Time of the Star Chamber, where the most arbitrary and destructive Judgments and Opinions were given, that ever an *Englishman* heard of, at least in his own Country: I say, Prosecutions for Libels since the Time of that arbitrary Court . . . have generally been set on Foot at the Instance of the Crown or its Ministers; and . . . these Prosecutions were too often and too much countenanced by the Judges, who held their Places at Pleasure, (a disagreeable Tenure to any Officer, but a dangerous one in the Case of a Judge.)[167]

Hamilton argued that existing law not only presented a danger by giving too much power to judges, it weakened the protection of the innocent by depriving juries of the right to make the critical determination on the criminality of a publication.[168] Finally, he pleaded directly to the jury "as Men who have baffled the Attempt of Tyranny."[169]

The judge instructed the jury to ignore Hamilton's argument and find Zenger guilty for printing the material he had previously admitted to printing.[170] The jury quickly returned a verdict of not guilty, "[u]pon which there were three Huzzas in the Hall which was crowded with people."[171]

It became an article of faith for those in the colonies that the jury was an essential buffer against abuses of authority, whether by governors, parliaments, or judges. One colonial writer described the principle that there be no conviction without a jury verdict as "the glorious Security thereby given for Freedom in writing and speaking."[172]

1966) [hereinafter FREEDOM OF THE PRESS].

162. *Id.* at 60.

163. *See id.* at 51.

164. *See id.* at 44.

165. *See id.* at 46.

166. *See id.* at 50-51.

167. *Id.* at 55.

168. *See id.* at 51. "This [practice] of leaving it to the Judgment of the Court, *whether the Words are libellous or not*, in Effect renders Juries useless (to say no worse) in many Cases . . . ." *Id.*

169. *Id.* at 59.

170. *See id.* at 60-61.

171. *Id.* at 61.

172. Smith, *supra* note 26, at 1420.

Liberty in America was seen as protection *from*, not by, colonial judges. In the Declaration of Independence, Thomas Jefferson included the symbiotic relationship between the judiciary and the King in the list of grievances: "He has obstructed the Administration of Justice, by refusing his Assent to Laws for establishing Judiciary Powers. He has made Judges dependent on his Will alone, for the tenure of their offices, and the amount and payment of their salaries."[173] By the time of the Revolution, Americans were well aware that their liberty, especially their liberty of the press, could be attacked by all branches of government.

When the Constitution for the new United States was drafted, there was, naturally, no provision protecting a free press because there was no Bill of Rights. It was argued that because the Constitution limited the areas in which the new federal government could act, there was not only no need for a Bill of Rights, but that its very inclusion might imply greater, and more ominous power, for the national government.[174]

While no one spoke against the need for "liberty of the press," many felt it was an invaluable, but undefinable concept. Benjamin Franklin wrote in 1789: "Few of us, I believe, have distinct Ideas of Its Nature and Extent."[175] Alexander Hamilton agreed, and wrote in the Federalist Papers: "What signifies a declaration that 'the liberty of the press shall be inviolably preserved?' What is the liberty of the press? Who can give it any definition which would not leave the utmost latitude for evasion?"[176]

The reality was somewhat different than this pessimistic assessment.[177] It is true that the outerlimits of liberty of the press were ill-defined and improperly understood.[178] The most significant question, which was to dominate discussion of the constitutionality of the Sedition Act of 1798, was the protection given for criticism of the government, specifically whether the English concept of seditious libel could co-exist with freedom of the press.[179] There was, however, wide-

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173. THE DECLARATION OF INDEPENDENCE para. 10-11 (U.S. 1776).

174. *See, e.g.*, THE FEDERALIST NO. 84, at 513-14 (Alexander Hamilton) (Clinton Rossiter ed., 1961). "For why declare that things shall not be done which there is no power to do? Why, for instance, should it be said that the liberty of the press shall not be restrained, when no power is given by which restrictions may be imposed?" *Id.* at 515.

175. BENJAMIN FRANKLIN, THE COURT OF THE PRESS (1789), *reprinted in* 10 THE WRITINGS OF BENJAMIN FRANKLIN 37 (Albert Smyth ed., 1907).

176. THE FEDERALIST NO. 84, *supra* note 174, at 514.

177. *See, e.g.*, David A. Anderson, *The Origins of the Press Clause*, 30 UCLA L. REV. 455, 537 (1983) ("[M]ost of the Framers perceived, however dimly, naively, or incompletely, that freedom of the press was inextricably related to the new republican form of government and would have to be protected if their vision of government by the people was to succeed.").

178. *See, e.g.*, LEVY, *supra* note 66, at 348 ("The First Amendment's injunction, that there shall be no law abridging the freedom of speech or press, was boldly stated if narrowly understood.").

179. An early awareness of this issue can be seen in a 1789 letter from William Cushing to John Adams, where Cushing argued that liberty of the press:

spread consensus on at least one critical principle: Liberty of the press must mean, at a bare minimum, no prior restraint. In other words, the substance protected by the First Amendment was not always clearly understood, but all appreciated that limitations imposed prior to publishing were simply unacceptable.

One of the earliest comprehensive definitions of liberty of the press came from James Wilson at the Pennsylvania state convention ratifying the Constitution. On December 1, 1787, Wilson, who was later to serve as a Justice on the first United States Supreme Court, declared:

> The idea of the liberty of the press, is not carried so far as this [permitting libels to go unpunished] in any country—what is meant by the liberty of the press is, that *there should be no antecedent restraint upon it*; but that every author is responsible when he attacks the security or welfare of the government, or the safety, character and property of the individual.
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> With regard to attacks upon the public, the mode of proceeding is by a prosecution. . . . [I]t must be tried where it was published, if the indictment is for publishing; and it must be tried likewise by a jury of that State.[180]

When Justice Joseph Story described the scope of liberty of the press protected by the First Amendment, he built on works concerning the English experience by William Blackstone and Jean DeLolme.[181] Justice Story condemned "previous restraints," whether coming from a licensor or a judge:

> must exclude *subsequent* restraints, as much as *previous restraints*. In other words, if all men are restrained by the fear of jails, scourges and loss of ears from examining the conduct of persons in administration and where their conduct is illegal, tyrannical and tending to overthrow the Constitution and introduce slavery, are so restrained from declaring it to the public *that* will be as effectual a restraint as any *previous* restraint whatever.

Id. at 199.

180. Statement at Pennsylvania ratifying convention, PENNSYLVANIA AND THE FEDERAL CONSTITUTION: 1787-1788, at 308-09 (John Bach McMaster & Frederick D. Stone eds., Da Capo Press 1970) (1888) (emphasis added).

181. *See* STORY, *supra* note 123, §§ 1878-79 (quoting BLACKSTONE, *supra* note 122; DELOLME, *supra* note 119). Blackstone's famous description of prior restraints shows his preference, if not enthusiasm for "subsequent punishment" of the press:

> To subject the press to the restrictive power of a licenser, as was formerly done, both before and since the revolution [of 1688], is to subject all freedom of sentiment to the prejudices of one man, and make him the arbitrary and infallible judge of all controverted points in learning, religion, and government. But to punish (as the law does at present) any dangerous or offensive writings, which, *when published*, shall on a fair and impartial trial be adjudged of a pernicious tendency, is necessary for the preservation of peace and good order . . . .

BLACKSTONE, *supra* note 122, at 152.

> [T]he liberty of the press, as understood by all England, is the right to publish *without any previous restraint, or license; so that neither the courts of justice, nor other persons, are authorized to take notice of writings intended for the press; but are confined to those which are printed.* And, in such cases, if their character is questioned, whether they are lawful, or libelous, is to be tried by a jury, according to the due proceedings of law.[182]

The understanding of the full scope of liberty of the press underwent a revolution a few years after ratification of the First Amendment, with the enactment of the Alien and Sedition Acts. This revolution continues today. However, from the beginning, there has been universal understanding that there could be no liberty of the press without a prohibition against previous restraints. No government official, judicial or otherwise, may be permitted to restrict the press prior to publication.

B. The Consensus Surrounding the Sedition Act

The Sedition Act of 1798 made it a crime to write "any false, scandalous and malicious" statements against either the President or Congress.[183] While the law permitted a defendant to escape penalty by proving the truth of the writing, and juries were permitted to decide critical questions of law and fact, there was no doubt that the Act was intended to silence critics of the entrenched political powers.

Supporters of the Act stated that the law was constitutional because it did not involve a prior restraint, but merely penalized speech after it had occurred:

> [T]he liberty of the press consists not in a license for every man to publish what he pleases without being liable to punishment, if he should abuse this license to the injury of others, but in a permission to publish, without previous restraint, whatever he may think proper, being answerable to the public and individuals, for any abuse of this permission to their prejudice.[184]

John Marshall also defended the Sedition Act in his Report on the Minority on the Virginia Resolutions, as being consistent with the First Amendment because it did not impose a prior restraint.[185] "It is known to all," he wrote, that

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182. *Id.* (emphasis added). It is noteworthy that in his treatise on equity, Justice Story equated injunctions on libel with the Star Chamber. *See* JOSEPH STORY, II COMMENTARIES ON EQUITY JURISPRUDENCE 136-37 (12th ed. 1887) (stating that courts of equity "have never assumed, at least since the destruction of the Court of Star Chamber, to restrain any publication which purports to be a literary work, upon the mere ground that it is of a libellous character").

183. The Sedition Act of 1798, ch. 74, 1 Stat. 596 (1798).

184. 5 ANNALS OF CONG. 2987-2990, 3003-14 (1799), *reprinted in* FREEDOM OF THE PRESS, *supra* note 161, at 1173-74.

185. *See* John Marshall, *Report of the Minority on the Virginia Resolutions*, J. House of

those who publish libels or who "libel the government of the state," may "be both sued and indicted."[186] However, he added:

> [T]he liberty of the press is a term which has a definite and appropriate signification, completely understood. It signifies a liberty to publish, *free from previous restraint,* any thing and every thing at the discretion of the printer only, but not the liberty of spreading with impunity false and scandalous slanders which may destroy the peace and mangle the reputation of an individual or of a community.[187]

The opponents of the Sedition Act did not disagree with the contention that prior restraints were prohibited under the First Amendment. They instead argued that protection against prior restraints was a necessary, but insufficient, condition to guarantee freedom of expression.

James Madison, for example, criticized the Act declaring: "It would seem a mockery to say that no laws should be passed preventing publications from being made, but that laws might be passed for punishing them in case they should be made."[188] Madison argued that freedom of the press meant not only a ban on prior restraints, but much more as well:

> This security of the freedom of the press requires that it should be exempt *not only from previous restraint* by the Executive, as in Great Britain, but from legislative restraint also; and this exemption, to be effectual, must be an exemption not only from the previous inspection of licensers, but from the subsequent penalty of laws.[189]

The Sedition Act expired by its own terms in 1801. In 1964, the Supreme

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Delegates (Va.) 6:93-95 (Jan. 22, 1799), *reprinted in* 5 THE FOUNDERS' CONSTITUTION 136-38 (Philip B. Kurland & Ralph Lerner eds., 1987) (emphasis added); *see also* Respublica v. Dennie, 4 Yeates 267 (1805). Judge Jasper Yeates instructed a jury on a charge of seditious libel:

> There shall be no licenses of the press. Publish as you please in the first instance without control; but you are answerable both to the community and the individual, if you proceed to unwarrantable lengths. . . . [I]f the consciences of the jury shall be clearly satisfied that the publication was seditiously, maliciously, and willfully aimed at the independence of the United States, the constitution thereof, or of this state, they should convict the defendant.

Id. at 269, 271. The defendant, publisher Joseph Dennie, was eventually acquitted after a jury trial. *See* LEVY, *supra* note 66, at 341.

186. THE FOUNDERS' CONSTITUTION, *supra* note 185, at 138 (quoting John Marshall).

187. *Id.* (quoting John Marshall).

188. James Madison, *The Virginia Report of 1799-1800, Touching the Alien and Sedition Laws*, *reprinted in* THE FOUNDERS' CONSTITUTION, *supra* note 185, at 141-42.

189. *Id.* (emphasis added). This reasoning was repeated by St. George Tucker, who annotated the work of Blackstone for application to the American system. *See* St. George Tucker, *Blackstone's Commentaries: with Notes of Reference, to the Constitution and Laws of the Federal Government of the United States; and the Commonwealth of Virginia* (1803), *reprinted in* FREEDOM OF THE PRESS, *supra* note 161, at 324.

Court finally agreed that Madison's fuller understanding of the First Amendment was correct, and the Court explicitly granted constitutional protection to criticism of government officials: "[T]he attack upon [the Sedition Act's] validity has carried the day in the court of history."[190]

The primary lesson of the Sedition Act is that the "profound national commitment to the principle that debate on public issues should be uninhibited, robust, and wide-open,"[191] requires that discussion of public issues be free from subsequent punishment. Opponents of the Sedition Act, however, uniformly acknowledged that such freedom was needed in addition to freedom from prior restraint. Both are necessary for the preservation of free expression.

C. *Judicial Understanding of Prior Restraints Before* Near v. Minnesota

1. *Injunctions Against Libels as Prior Restraints.*—After the end of the Sedition Act, prosecutions for seditious libel ceased to be a serious threat to Nineteenth Century freedom of expression. While common law libel actions were often successful, state court judges throughout the country recognized what modern scholars had forgotten: A fundamental connection exists between the traditional rule that courts may not enjoin libels and the doctrine of prior restraints.[192]

It had long been a maxim in English common law that "equity will not enjoin a libel."[193] In 1827, New York enacted a law codifying the similar prevailing American view that the press, even when guilty of libel, should not be subject to restraints in advance of future publication.[194] The law, which permitted criminal courts to require guilty parties to "give security to keep the peace," explicitly exempted libels and other writing offenses.[195] It stated, "this section shall not extend to convictions for writing or publishing any libel; nor shall any such security be hereafter required by any court, upon any complaint, prosecution or conviction, for any such writing or publishing."[196] It was later remarked that this provision reflected the legislature's determination that, in regards to a free press, "a power of preventive justice . . . cannot safely be entrusted to any tribunal consistently with the principles of a free government."[197]

The first state court decision to recognize explicitly the link between injunctions on libel and prior restraints was the 1839 New York case of

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190. N.Y. Times Co. v. Sullivan, 376 U.S. 254, 276 (1964).

191. *Id.* at 270.

192. These libel cases only involved state causes of actions, because the U.S. Supreme Court ruled in 1812 that there was no common law jurisdiction in the federal courts. *See* United States v. Hudson & Goodwin, 11 U.S. 32 (1812).

193. *See supra* notes 106-11 and accompanying text.

194. 2 N.Y. REV. STAT. 737, § 1 (1827-88).

195. *Id.*

196. *Id.*

197. Brandreth v. Lance, 8 Paige Ch. 24, 26 (N.Y. 1839).

Brandreth v. Lance.[198] The seller of "Brandreth's Vegetable Universal Pills,"[199] had sought to enjoin publication of a made-up "autobiography."[200] The court dismissed the complaint, stating that it could not assume jurisdiction "without infringing upon liberty of the press."[201] Chancellor Walworth's opinion stressed that for a court to enjoin a publication would mark a dangerous return to the days of the Star Chamber:

> The court of star chamber in England, once exercised the power of cutting off the ears, branding the foreheads, and slitting the noses of the libellers of important personages. And, as an incident to such a jurisdiction, that court was undoubtedly in the habit of restraining the publication of such libels by injunction.[202]

Chancellor Walworth then stated that, since the end of the Star Chamber, only one court "either in this country or in England, has attempted, by an injunction or order of the court, to prohibit or restrain the publication of a libel, as such, in anticipation."[203] He added with evident satisfaction that "[t]he house of commons, however, considered this extraordinary exercise of power on the part of [the notorious] Scroggs as a proper subject of impeachment."[204]

In 1876, the Missouri Court of Appeals denied an insurance company's request to enjoin a libel, stating that such an injunction would violate Missouri's constitutional guarantee of free speech.[205] The court held that even if the insolvency of the defendant meant that there was no adequate remedy at law, the constitutional guarantee forbade injunctions against speech:

> It is obvious that, if this remedy be given on the ground of the insolvency of the defendant, the freedom to speak and write, which is secured, by the Constitution of Missouri, to all its citizens, will be

198. *Id.* at 24.

199. *Id.*

200. *See id.*

201. *Id.* at 26.

202. *Id.* at 24 (citation omitted). While it was perhaps technically inaccurate to say that the Star Chamber issued formal "injunctions" against libels, *see* Roscoe Pound, *Equitable Relief Against Defamation and Injuries to Personality*, 29 HARV. L. REV. 640, 650 (1916), the Star Chamber unquestionably exercised coercive preventative power over printing both through its licensing authority and its ability to prosecute offenders without a jury. *See supra* notes 27-58 and accompanying text.

203. Brandreth, 8 Paige Ch. at 26.

204. *Id.* (citation omitted). Lord Chief Justice William Scroggs had imposed a ban on the publication of a book in 1680. *See* Trial of Henry Carr, 7 State Trials 1111, 1115 (1680). Scroggs was impeached by the House of Commons ten years later. Proceedings against Lord Chief Justice Scroggs were brought before the Privy Council. *See* 8 State Trials 163, 199 (1680).

205. *See* Life Ass'n of Am. v. Boogher, 3 Mo. App. 173 (1876). Missouri's constitutional free speech provision stated: "[E]very person may freely speak, write, or print on any subject, being responsible for the abuse of that liberty." *Id.* at 180.

> enjoyed by a man able to respond in damages to a civil action, and denied to one who has no property liable to an execution.[206]

Finally, the court rejected the plea for a temporary injunction while the merits of the defamation action were being considered, explaining that "[w]e have no power to suspend that right for a moment, or for any purpose."[207] The court ended by explaining that a judicially imposed injunction was the equivalent of the censor's licensing power as a forbidden prior restraint on speech.[208] "The sovereign power has forbidden *any instrumentality of the government* it has instituted to limit or restrain this right except by the fear of the penalty, civil or criminal, which may wait on abuse."[209]

One year after the Missouri decision, the New York Court of Common Pleas agreed that a temporary injunction against an alleged libel would violate the state's constitutional guarantee of free speech.[210] The New York Juvenile Guardian Society had sued to enjoin Teddy Roosevelt, a commissioner of the State Board of Charities, from publishing the results of an investigation which found misuse of the charity's funds. The court declared that a court of equity had no power to restrain defamatory publications and linked this rule to freedom of expression:

> [T]he exercise of any such jurisdiction being repugnant to the provision of the Constitution, which declares (art. I, § 8) that every citizen may freely speak, write and publish his sentiments on all subjects, being responsible for the *abuse* of that right; and that no law shall be passed to restain [sic] or abridge the liberty of speech or of the press.[211]

This principle was reaffirmed by the New York Court of Appeals in 1902, which stated the enjoining of libels interfered with both freedom of the press and the right to a jury trial.[212] The court stated that:

> [Enjoining libels] would open the door for a judge sitting in equity to establish a censorship not only over the past and present conduct of a publisher of a magazine or newspaper, but would authorize such judge

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206. *Id.* at 176.

207. *Id.* at 180.

208. *See id.*

209. *Id.* (emphasis added). This principle was reaffirmed by the Missouri Supreme Court in *Flint v. Hutchinson Smoke Burner Co.*, 19 S.W. 804 (Mo. 1892). The Missouri Supreme Court stated that there were "exceptions in star chamber times, but such exceptions serve to make firm the general rule that a court of equity possessed no such power." *Id.* at 806. The court in *Flint* concluded that enjoining libels violated both freedom of the press and the right to a jury determination. *See id.* at 805; *accord* Wolf v. Harris, 184 S.W. 1139 (Mo. 1916); Hamilton-Brown Shoe Co. v. Saxey, 323 S.W. 1106 (Mo. 1895).

210. *See* N.Y. Juvenile Guardian Soc'y v. Roosevelt, 7 Daly 188 (N.Y. Ct. Common Pleas 1877).

211. *Id.* at 191.

212. *See* Marlin Fire Arms Co. v. Shields, 64 N.E. 163 (N.Y. 1902).

> by decree to lay down a chart for future guidance in so far as a plaintiff's property rights might seem to require . . . .[213]

Probably the most extensive discussion of the link between injunctions against defamation and prior restraints in the Nineteenth Century, came from an 1882 decision of the Louisiana Supreme Court in *State ex rel. Liversey v. Judge of Civil District Court*.[214] In that case, W. Van Benthuysen obtained an injunction against a newspaper, *The Mascot*, ordering it not to publish libelous cartoons against him. When the paper published more cartoons, its publisher was held in contempt. The Louisiana Supreme Court not only declared the injunction unconstitutional, the court also annulled the publisher's contempt conviction on the ground that the injunction was void.[215]

The Louisiana Supreme Court began by stating that even though the language of its constitutional guarantee that "no law shall be passed abridging the freedom of the press" differed in language from the U.S. Constitution and like provisions in other states,[216] "they all signify the same thing, and convey the general idea which is crystallized in the common phrase, 'liberty of the press.'"[217] Quoting a law dictionary, the court acknowledged the link between injunctions and other forms of prior restraints: "The favorite idea in England and America has been that every person may freely publish what he sees fit, and any judgment of the law upon it shall be reserved till afterwards."[218] After describing the prohibition against all forms of prior restraint, the court stated, "[p]erhaps in the whole range of legal propositions, susceptible of dispute, there is not one that commands so unanimous a concurrence of judges and jurists."[219]

The court then noted the difficulty in ascertaining whether particular statements were defamatory or not, and whether or not they were privileged. Because of this lack of certainty, "[t]here would be no safe course, except to take the opinion of the judge beforehand, or to abstain entirely from alluding to the plaintiff. What more complete censorship could be established?"[220] The court concluded that such a scheme would have a devastating effect on freedom of the press: "Under the operation of such a law, with a subservient or corrupt

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213. *Id.* at 165.

214. 34 La. Ann. 741 (La. 1882).

215. *See id.* at 742.

216. *Id.* at 743 (quoting the Louisiana Bill of Rights). The court noted that Maine's constitutional provision was typical of states such as New York, New Jersey, Pennsylvania, Delaware, Maryland, Ohio, and Illinois: "Every citizen may freely speak, write and publish his sentiments on any subject, being responsible for the abuse of this liberty." *Id.* at 744 (quoting the Maine Constitution). The court stated that although these provisions "are fuller in expression" than Louisiana's, they "are merely intended to convey the recognition of the same general principle, 'liberty of the press' as a fundamental right of the citizen." *Id.*

217. *Id.* at 743.

218. *Id.* (citation omitted).

219. *Id.*

220. *Id.* at 745.

judiciary, the press might be completely muzzled, and its just influence upon public opinion entirely paralyzed."[221]

Upon concluding that an injunction against defamatory statements violated liberty of the press, the court then ruled that the publisher could not be punished for violating the injunction: "[W]here the court had no power to grant the injunction, and where the mandate is, therefore, absolutely void, the defendants cannot be punished for contempt for its alleged violation."[222]

Similarly, two Texas state courts' injunctions against defamatory statements were also found to violate that state's constitutional protection for freedom of expression. In a 1909 case, *Mitchell v. Grand Lodge, Free & Accepted Masons of Texas*,[223] the court ruled that the state's "constitutional guaranty of liberty of speech furnishes an additional reason for the application in Texas of the general rule that an injunction will not issue to restrain the publication of a libel."[224] In 1923, another Texas court agreed, stating that the purpose of that constitutional provision "is to preserve the liberty of speech . . . and to inhibit a court of equity from supervising one person's opinion of another or from dictating what one person may say of another. . . ."[225]

The Alabama constitutional guarantee of freedom of the press was similarly held to bar injunctions against defamation.[226] In 1909, a U.S. District Court held

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221. *Id.*

222. *Id.* at 746 (citations omitted). The court explained that the publisher could be punished pending final review of his violation of the injunction, but the punishment would end thereafter:

> He must endure the consequences of his disobedience until, in some orderly course of procedure, he procures from competent authority the annulment of the mandate claimed to be unconstitutional and void; but the moment such annulment is pronounced, his condemnation for contempt falls with it, and his sentence, though not completely executed, expires.

Id. Some courts, however, held that even if an injunction against a libel was improper, a party violating that injunction could still be held in contempt. *See* Christian Hosp. v. People *ex rel.* Murphy, 79 N.E. 72, 74 (Ill. 1906). This was also the position of the U.S. Supreme Court in adopting the collateral bar rule. *See* Walker v. City of Birmingham, 388 U.S. 307, 317-21 (1967).

223. 121 S.W. 178 (Tex. Civ. App. 1909).

224. *Id.* at 179. The relevant Texas constitutional provision stated:

> Every person shall be at liberty to speak, write or publish his opinions on any subject, being responsible for the abuse of that privilege; and no law shall ever be passed curtailing the liberty of speech or of the press. . . . And in all indictments for libels, the jury shall have the right to determine the law and the facts, under the direction of the court, as in other cases.

TEX CONST. art. I, § 8 (2000).

225. Strang v. Biggers, 252 S.W. 826, 826 (Tex. Civ. App. 1923). The court went on to add that although libels could not be enjoined, they could be punished, because the law held "all persons accountable for the misuse of this right of free speech." *Id.*

226. The Alabama Constitution states that "no law shall ever be passed to curtail or restrain the liberty of speech or of the press; and any person may speak, write, and publish his sentiments on all subjects, being responsible for the abuse of that liberty." ALA CONST. art. I, § 4.

that the Alabama state constitution forbade enjoining a libel defaming the plaintiff's credit and business standing.

> The wrongs and injury, which often occur from lack of preventive means to suppress slander, are parts of the price which the people, by their organic law, have declared it is better to pay, than to encounter the evils which might result if the court were allowed to take the alleged slanderer or libeler by the throat, in advance.[227]

Eight years later, another U.S. District Court in Alabama refused to enjoin a defamatory attack on the maker of an alcohol-laced medicine, stating, "it is not within the authority of any court, or of any other governmental agency, by any sort of censorship to abridge the right belonging to every man to freely speak and publish his sentiments."[228]

Similar holdings were reached by other federal courts. In a 1900 case from Oregon, an injunction for a libel was denied: "The court cannot assume to supervise the publication of offending newspapers, or otherwise constitute itself a press censor."[229] In a 1907 case interpreting South Dakota's constitutional right to free expression, the court concluded, "[i]n the jurisprudence of the United States there is no remedy for the abuse of this right . . . except an action at law for damages or a criminal proceeding by indictment or information."[230]

In 1916, the Nebraska Supreme Court joined the list of courts which explicitly linked the equitable ban on enjoining defamations with the constitutional prohibition on prior restraints.[231] The court, in refusing to enjoin publication of a false statement that a candidate was not actually running for Governor, declared: "The power to exercise a censorship over political publications, as formerly practiced, is taken away. The exercise of censorship by a court of equity through the writ of injunction is no less objectionable than the exercise of that function by other departments of the government."[232]

The cases detailed in this section prove, that from the very beginning of the Republic, American courts have understood that permitting libels to be enjoined gave judges the same censorial control over prospective speech as had been wielded by licensors of old.[233] The following few sections of this Article

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227. Citizens' Light, Heat & Power Co. v. Montgomery Light & Water Power Co., 171 F. 553, 556 (M.D. Ala. 1909).

228. Willis v. O'Connell, 231 F. 1004, 1010 (S.D. Ala. 1916).

229. Balliet v. Cassidy, 104 F. 704, 706 (D. Or. 1900).

230. Montgomery Ward & Co. v. S.D. Retail Merchs.' & Hardware Dealers' Ass'n, 150 F. 413, 418 (D. S.D. 1907) (citations omitted). The South Dakota Constitution states, "[e]very person may freely speak, write and publish on all subjects, being responsible for the abuse of that right." S.D. CONST. art. VI, § 5.

231. *See* Howell v. Bee Pub. Co., 158 N.W. 358 (Neb. 1916).

232. *Id.* at 359.

233. Many of the courts that denied injunctions for defamatory statements merely cited the equitable rule without mentioning the constitutional interest in free expression. Some judges, such as Supreme Court Justice Bradley, sitting on circuit in *Kidd v. Horry*, 28 F. 773, 776 (E.D. Pa.

illustrate questions about enjoining speech intertwined with conduct, such as picketing or parades, which have been difficult for courts to resolve. Nonetheless, there remained wide-spread agreement that an injunction against pure speech was an impermissible prior restraint.

2. *Prior Restraints and Labor Disputes*.—Labor disputes around the turn of the 20th century presented courts with the challenge of applying principles of free expression in a novel and volatile context. While many courts focused primarily on the threat of violence or potential harm to businesses, a number of courts did understand that injunctions against the speech and protests of unions could very well violate the traditional prohibition against prior restraints.

When "boycotting" a business was held to be an illegal conspiracy, injunctions against speeches and circulars in support of such boycotts were freely granted. In 1911, the U.S. Supreme Court upheld the one-year jail term for Samuel Gompers for violating an injunction that had barred the urging of a boycott against Buck's Stove and Range Company or publishing the name of the company on "Unfair Lists."[234] The Court said that the injunction did not violate freedom of expression because the prohibited words were a signal to implement an illegal conspiracy.[235] Thus, the injunction was not against pure speech, but against "verbal acts," which, the Court added, were as much subject to being enjoined "as the use of any other force whereby property is unlawfully damaged."[236]

There were many similar decisions. As Felix Frankfurter and Nathan Greene wrote in their 1930 book, *The Labor Injunction*, the injunction became the

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1886), tied the ban on enjoining defamations to the constitutional requirement of a jury trial. Most judges, however, just cited the rule that equity will not enjoin a libel. *See, e.g.*, Francis v. Flinn, 118 U.S. 385 (1886); Robert E. Hicks Corp. v. Nat'l Salesmen's Training Ass'n, 19 F.2d 963 (7th Cir. 1927); Vassar Coll. v. Loose-Wiles Biscuit Co., 197 F. 982 (W.D. Mo. 1912); Edison v. Thomas A. Edison, Jr. Chem. Co., 128 F. 1013 (D. Del. 1904); Computing Scale Co. v. Nat'l Computing Scale Co., 79 F. 962 (N.D. Ohio 1897); Baltimore Car-Wheel Co. v. Bemis, 29 F. 95 (D. Mass. 1886); Donaldson v. Wright, 7 App. D.C. 45 (1895); Singer Mfg. Co. v. Domestic Sewing Mach. Co., 49 Ga. 70 (1873); Allegretti Chocolate Cream Co. v. Rubel, 83 Ill. App. 558 (1899); Everett Piano Co. v. Bent, 60 Ill. App. 372 (1895); Raymond v. Russell, 9 N.E. 544 (Mass. 1887); Whitehead v. Kitson 119, Mass. 484 (1876); Boston Diatite Co. v. Florence Mfg. Co., 114 Mass. 69 (1873); Flint v. Hutchinson Smoke Burner Co., 19 S.W. 804 (Mo. 1892); Mayer v. Journeymen Stone-Cutters' Ass'n, 20 A. 492 (N.J. Ch. 1890); Owen v. Partridge, 82 N.Y.S. 248 (Sup. Ct. 1903); Mauger v. Dick, 55 How. Pr. 132 (N.Y. Sup. Ct. 1878). One such court ruled that the equity rule was not based on constitutional reasons and could be changed by statute. *See* Chamber of Commerce of Minneapolis v. FTC, 13 F.2d 673 (8th Cir. 1926). A small minority of courts actually ruled that libels could be enjoined. *See* Warren Featherbone Co. v. Landauer, 151 F. 130 (E.D. Wis. 1903); Emack v. Kane, 34 F. 46 (N.D. Ill. 1888); *see also* Palmer v. Travers, 20 F. 501 (S.D.N.Y. 1884) (permitting injunction for libel if defendant threatens repetition).

234. Gompers v. Bucks Stove & Range Co., 221 U.S. 418 (1911).

235. *See id.* at 439.

236. *Id.*

central lever in the administration of justice between employer and employee.[237] While some courts enjoined publications which were accompanied by "threats, express or covert, or intimidation and coercion,"[238] others went so far as to bar speech that was merely "annoying" or "indecent," or that contained "opprobrious epithets."[239]

One of the first steps in recognizing that picketing and persuasion in the labor context could be protected without sanctioning violence and illegality came in a dissent by Oliver Wendell Holmes in an 1896 Massachusetts case.[240] The Massachusetts Supreme Judicial Court upheld enjoining, as a nuisance, a two-person picket in front of a factory.[241] Holmes condemned as "unwarranted" the "assumption that the patrol necessarily carries with it a threat of bodily harm."[242] Holmes also criticized the use of the word "threats" in labor injunctions, noting that a threat is not necessarily unlawful; "it depends on what you threaten."[243]

The most eloquent defense of freedom of expression in the labor context came from the Montana Supreme Court in 1908. In *Lindsay & Co. v. Montana Federation of Labor*,[244] the court struck down a lower court order enjoining a labor union from distributing written materials "containing opprobrious or injurious epithets."[245] The court said that for a judge to tell an individual what not to publish, even regarding a "conspiracy to boycott," is analogous to if the court were to "determine in advance just what the citizen may or may not speak or write upon a given subject—is, in fact, to say that such court is a censor of speech as well as of the press."[246] Referring to the state's constitution,[247] the court declared:

> It cannot be said that a citizen of Montana is free to publish whatever he will on any subject, while an injunction preventing him from publishing a particular item upon a particular subject hangs over his head like a sword of Damocles, ready to fall with all the power which can be invoked in contempt proceedings . . . .[248]

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237. Felix Frankfurter & Nathan Greene, The Labor Injunction 52 (1930).

238. Beck v. Ry. Teamsters' Protective Union, 77 N.W. 13, 24 (Mich. 1898).

239. Frankfurter & Greene, *supra* note 237, at 89-106; *see also* Rabban, *supra* note 127, at 169-73.

240. *See* Vegelahn v. Guntner, 44 N.E. 1077 (Mass. 1896).

241. *See id.* at 1078.

242. *Id.* at 1080 (Holmes, J., dissenting).

243. *Id.* at 1081 (Holmes, J., dissenting).

244. 96 P. 127 (Mont. 1908).

245. *Id.* at 128.

246. *Id.* at 131.

247. The relevant constitutional provision stated: "No law shall be passed impairing the freedom of speech; every person shall be free to speak, write, or publish whatever he will on any subject, being responsible for all abuse of that liberty." *Id.* (quoting Mont. Const. of 1884, art. III, § 10).

248. *Id.*

A similar decision was announced in 1902 by the Missouri Supreme Court.[249] In refusing to enjoin a union from proclaiming or conveying a boycott to others, the court stated that such an injunction would be an unconstitutional prior restraint: "The two ideas, the one of absolute freedom 'to say, write or publish whatever he will on any subject,' coupled with responsibility therefor, and the other idea of *preventing* any such free speech, free writing or free publication *can not coexist*."[250]

The Texas Supreme Court also condemned an injunction against a labor union, under which union organizers were arrested for contempt for "villifying, abusing, or using approbrious epithets" to telephone company employees.[251] Equating the injunction to "a system of only licensed speech or licensed printing[,]"[252] the court declared:

> Let it once be admitted that courts may arrogate the authority of deciding what the individual may say and may not say, what he may write and may not write, and by an injunction writ require him to adapt the expression of his sentiments to only what some judge may deem fitting and proper, and there may be readily brought about the very condition against which the constitutional guaranty was intended as a permanent protection. Liberty of speech will end where such control of it begins.[253]

Courts continued to enjoin picketing and other labor-related expression that involved threats of violence or intimidation.[254] However, a growing number of courts realized that "[u]nder the name of persuasion, duress may be used; but it is duress, not persuasion, that should be restrained and punished."[255] Enjoining such persuasion, according to a 1924 Illinois Supreme Court decision, would result in labor speech being "subject to the supervision of a censor."[256] In reversing a contempt citation for violating an injunction banning the use of the word "'scabs,' or other offensive, scurrilous or opprobrious names," the court

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249. *See* Marx & Hass Jeans Clothing Co. v. Watson, 67 S.W. 391 (Mo. 1902).

250. *Id.* at 393.

251. *Ex parte* Tucker, 220 S.W. 75, 75 (Tex. 1920) (quoting the District Court of Anderson County).

252. *Id.* at 76.

253. *Id.*

254. *See* Am. Malting Co. v. Keitel, 209 F. 351, 363 (2d Cir. 1913) (enjoining false statements designed to cause customers to breach contracts); *accord* Am. Law Book Co. v. Edward Thompson Co., 84 N.Y.S. 225 (Sup. Ct. 1903).

255. Iron Molders' Union No. 125 v. Allis Chalmers Co., 166 F. 45, 51 (7th Cir. 1908); *see also* Everett Waddey Co. v. Richmond Typographical Union, No. 90, 53 S.E. 273, 278 (Va. 1906) ("The evidence, we think, fails to make a case showing that appellees have in any way so molested, annoyed or damaged the appellants in the conduct of their business as to entitle them to the extraordinary relief by injunction.").

256. Vulcan Detinning Co. v. St. Clair, 145 N.E. 657, 659 (Ill. 1924).

stated that no court of equity "has the power to restrain and punish members of a labor union from speaking, writing or publishing on the subject of a dispute between the union and the employer."[257]

3. Parades and the Perils of Unlimited Discretion.—Unlike "pure speech," the use of public streets for parades or demonstrations necessitates some kind of government involvement. Cities have the right to regulate their public thoroughfares, both for traffic and for avoiding conflicts with the rights of others.[258] However, beginning in the mid-1880s, many courts recognized that granting government officials unlimited discretion in determining who may use the public streets was a dangerous infringement on freedom of expression.

Many of these early cases involved the Salvation Army, which sought to parade and play music in cities throughout the country. From 1884 through 1886, the Salvation Army paraded through Grand Rapids, Michigan, much to the dismay of the local government.[259] After repeated prosecutions for public nuisance ended with acquittals, the city passed an ordinance banning all parades, except for funeral and military processions, "without having first obtained the consent of the mayor."[260] The Michigan Supreme Court ruled that it was unconstitutional to make the right to communicate on public streets subject "to an unregulated official discretion."[261] The court held it impermissible for "a mayor or council to shut off processions of those whose notions did not suit their views or tastes, in politics or religion, or any other matter on which men differ. When men in authority have arbitrary power, there can be no liberty."[262]

A similar parade law was struck down by the Kansas Supreme Court in 1888.[263] That court ruled that unlimited discretion over which groups could parade violated the right of the people to communicate on political or religious issues, and that any regulation must apply in an even-handed manner to every speaker:

> All by-laws made to regulate parades must fix the conditions upon which all persons or associations can move upon the public streets,

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257. *Id.*

258. For an early discussion of this, see *State v. White*, 5 A. 828 (N.H. 1886). For a fascinating discussion of weaknesses of this rule, see C. EDWIN BAKER, HUMAN LIBERTY AND FREEDOM OF SPEECH 138-60 (1989).

259. *See In re* Frazee, 30 N.W. 72, 74 (Mich. 1886).

260. *Id.* at 73.

261. *Id.* at 76.

262. *Id.* A similar parade law was upheld in Massachusetts in *Commonwealth v. Plaisted*, 19 N.E. 224 (Mass. 1889). That court incorrectly distinguished the *Frazee* case on the mistaken ground that the Michigan court had merely ruled that the city council lacked "legislative authority" to pass such an ordinance. *Id.* at 383.

263. *See* Anderson v. City of Wellington, 19 P. 719 (Kan. 1888). In *Anderson*, members of the Salvation Army were arrested for parading in violation of a local ordinance which made is "unlawful . . . to parade any public street . . . without having first obtained in writing the consent of the mayor." *Id.* at 720.

> expressly and intelligently; . . . and must not give the power of permitting or restraining processions to an unregulated official discretion, and thus allow an officer to prevent those with whom he does not agree on controverted questions from calling public attention to the principles of their party . . . .[264]

In Illinois, it was held unconstitutional to grant unlimited discretion over parades to either the chief of police or the city council.[265] As one court noted: "When men in authority are permitted in their discretion to exercise power so arbitrary, liberty is subverted, and the spirit of our free institutions violated. And it is all the same whether that discretion is exercised by one man or several."[266]

The most impassioned decision striking down a law granting city officials unlimited discretion over parades was the Wisconsin Supreme Court in its 1893 decision, *State ex rel. Garrabad v. Dering*.[267] The court stated that authorizing such discretion resembled "a petty tyranny, the result of prejudice, bigotry, and intolerance, [more] than any fair or legitimate provision in the exercise of the police power of the state."[268] The court concluded with a powerful denunciation of the evils of unlimited discretion:

> It is entirely un-American and in conflict with the principles of our institutions and all modern ideas of civil liberty. It is susceptible of being applied to offensive and improper uses, made subversive of the rights of private citizens, and it interferes with and abridges their privileges and immunities, and denies them the equal protection of the laws . . . .[269]

4. Banning Newspapers.—Of all the attempts to control free expression, none is a more blatant violation of the traditional ban on prior restraints than the direct legislative ban on a particular publication. Prior to *Near*, several localities tried to enact such bans, which were uniformly rejected by the courts.

In 1893, the city council of Seguin, Texas, voted that the *Sunday Sun* was a public nuisance and thus could not be sold within the city limits.[270] In finding this action unconstitutional, the Texas Court of Criminal Appeals stated that, "[t]he power to suppress one concedes the power to suppress all, whether such publications are political, secular, religious, decent or indecent, obscene or otherwise."[271] Thus, declared the court, "[t]he power to prohibit the publication of newspapers is not within the compass of legislative action in this State, and

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264. *Id.* at 723.

265. *See* City of Chicago v. Trotter, 26 N.E. 359 (Ill. 1891); Rich v. City of Naperville, 42 Ill. App. 222 (1891).

266. *Rich*, 42 Ill. App. at 224-25.

267. 54 N.W. 1104 (Wis. 1893).

268. *Id.* at 1107.

269. *Id.*

270. *See Ex parte* Neill, 22 S.W. 923 (Tex. Crim. App. 1893).

271. *Id.* at 924.

any law enacted for that purpose would clearly be in derogation of the Bill of Rights." [272]

In 1908, a New York court enjoined the police of the city of Kingston from repeating their seizure and destruction of copies of the *Ulster Square Dealer*.[273] While conceding that the newspaper had published "reckless and scurrilous" libels, the court stated, "[t]wo wrongs can never make a right."[274] Recognizing the similarity between the police seizure of newspapers and a traditional prior restraint, the court declared: "No one can take unto himself the right of suppressing in advance the publication of the printed sentiments of another citizen on any public or private question."[275]

During World War I, another New York city, Mount Vernon, voted to ban two papers, the *New York American* and the *New York Evening Journal*, until the end of the war.[276] In striking down this ban, the court recognized that the ban constituted an impermissible prior restraint: "It would seem that the legislature itself . . . would have no authority to prohibit in advance the plaintiff or any other accused person from printing and issuing newspapers or other publications."[277]

In 1921, a federal court struck down the attempt by the mayor of Cleveland, Ohio, to ban the *Dearborn Independent* as tending to cause breach of peace due to its anti-Semitic articles.[278] The court reiterated that the only remedy for offensive publications were prosecutions for specific offenses after publication, rather than "the establishment of a censorship in advance of future publications."[279] Otherwise, the court declared the freedom of the press "would be placed at the mercy of every public official who for the moment was clothed with authority to preserve the public peace, and the right to a free press would likewise be destroyed."[280]

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272. *Id.* at 923-24.

273. *See* Ulster Square Dealer v. Fowler, 111 N.Y.S. 16 (Sup. Ct. 1908).

274. *Id.* at 17.

275. *Id.* at 17-18. The court concluded: "The plaintiff has the right to publish a newspaper; and defendants cannot determine for themselves in advance as to the propriety of that publication . . . ." *Id.* at 18.

276. *See* Star Co. v. Brush, 170 N.Y.S. 987 (Sup. Ct. 1918).

277. *Id.* at 990. The court quoted from an earlier New York case declaring that liberty of the press prevents injunctions against defamation: "Individuals are free to talk and the press is at liberty to publish, and neither may be restrained by injunction, but they are answerable for the abuse of this privilege in an action for slander or libel under the common law . . . ." *Id.* (quoting Stuart v. Press Publ'g, 82 N.Y.S. 401, 408 (App. Div. 1903)). The court's finding that the ban was unconstitutional was affirmed on appeal. *See* Star Co. v. Brush, 172 N.Y.S. 851, 851-52 (App. Div. 1918) (stating "[i]t is clear that such a ban on a newspaper by a city or municipality is beyond its powers, as it would thereby invade the constitutional rights of a free press").

278. *See* Dearborn Publ'g Co. v. Fitzgerald, 271 F. 479, 480 (N.D. Ohio 1921).

279. *Id.* at 482.

280. *Id.* at 485.

5. The Road to Near.—It may well be true, as many have stated, that "[s]ince the 1931 release of the Supreme Court's opinion in *Near v. Minnesota*, the doctrine of prior restraint has been an essential element of first amendment jurisprudence."[281] However, as a review of the many cases cited in this section shows, the doctrine of prior restraint has been an essential element of American jurisprudence since the end of the Revolutionary War. If this history is ignored, modern commentators will overestimate the novelty of *Near v. Minnesota* and, more dangerously, underestimate the solidity of its holding.

For one final example, consider the 1896 case from the California Supreme Court, *Dailey v. Superior Court*.[282] In *Dailey*, a trial court had enjoined the showing of a play, *The Crime of a Century*, which was based on the facts of a pending murder case. The California Supreme Court ruled that such an injunction would be an unconstitutional prior restraint.[283] The state court declared the injunction was invalid because the "petitioner's mouth could not be closed in advance for the purpose of preventing an utterance of his sentiments, however mischievous the prospective results of such utterance."[284]

The road to *Near* was a virtual straight path from the Star Chamber and common law courts, through the colonial and Revolutionary period, from the drafting of the First Amendment through the start of the Twentieth century. Whatever else freedom of communication means to Americans, it has always included freedom from all prior restraints. Neither licensors nor governors, police nor judges, may attempt to halt speech before it is communicated.

D. A Near*-Great Decision*

In its landmark 1931 decision, *Near v. Minnesota ex rel. Olson*,[285] the Supreme Court struck down a Minnesota law which permitted the State to obtain a court order abating defamatory newspapers as a nuisance.[286] A state court issued an injunction barring *The Saturday Press* from publishing or distributing "any publication whatsoever which is a malicious, scandalous or defamatory newspaper, as defined by law."[287] That state court noted that *The Saturday Press* was not barred from all publishing; it was still permitted to operate "a newspaper

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281. Scordato, *supra* note 2, at 2.

282. 44 P. 458 (Cal. 1896).

283. *See id.* at 460. The relevant California constitutional provision read: "Every citizen may freely speak, write, and publish his sentiments on all subjects, being responsible for the abuse of that right; and no law shall be passed to restrain or abridge the liberty of speech or of the press." CAL. CONST. app. I, art. I, § 9.

284. *Dailey*, 44 P. at 460.

285. 283 U.S. 697 (1931).

286. *See id.* at 698.

287. *Id.* at 712. *See also* FRED W. FRIENDLY, MINNESOTA RAG: THE SCANDAL SHEET THAT SHAPED THE CONSTITUTION (1981) (giving a classic description of *The Saturday Press* and the *Near* case).

in harmony with the public welfare to which all must yield."[288]

The Supreme Court, in a 5-4 decision, ruled the law an unconstitutional prior restraint. The opinion by Chief Justice Hughes declared that "it has been generally, if not universally, considered that it is the chief purpose of the guaranty [of liberty of the press] to prevent previous restraints upon publication."[289] Unfortunately, the Court did not attempt to define the meaning of the phrase "prior restraint," but instead directed attention to the statute's "operation and effect."[290] Noting that the "object and effect" of the statute was to "suppress" future publication, the Court described the operation of the statute as putting "the publisher under an effective censorship."[291]

The primary offending feature of the statute, according to the Court, was that upon a finding that a publisher had distributed a "malicious, scandalous and defamatory" newspaper, the "resumption of publication is punishable as a contempt of court by fine or imprisonment."[292] The court's injunction, "would lay a permanent restraint upon the publisher, to escape which he must satisfy the court as to the character of a new publication."[293] Whether future publications would be free from punishment would depend upon whether the publisher was able "to satisfy the judge that the charges are true and are published with good motives and for justifiable ends."[294] This, explained the Court, "is of the essence of censorship."[295]

The strength of the *Near* decision is the historical accuracy and practical relevance of its holding that an injunction against expression should be viewed as an unconstitutional prior restraint. The fact that a judge's order directed against the future communication of a particular speaker would have the same debilitating effect on free communication as the censorship of the Star Chamber's licensors had long been recognized in England and America, in numerous court decisions, and by treatise writers. *Near* was a declaration that

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288. *Near*, 283 U.S. at 712.

289. *Id.* at 713. For its description of "the conception of the liberty of the press as historically conceived and guaranteed," the Court cited both Blackstone and DeLolme. *Id.* at 713-14. For an analysis of the work of both Blackstone and DeLolme, see *supra* notes 113-25 and accompanying text.

290. *Id.* at 708.

291. *Id.* at 712.

292. *Id.*

293. *Id.*

294. *Id.* at 713.

295. *Id.* The Court made a point of declaring that the constitutional ban on prior restraints was not "absolutely unlimited," but was subject to limitation "only in exceptional cases." *Id.* at 716. The Court listed four such cases: 1) "actual obstruction to [the Government's] recruiting service or the publication of the sailing dates of transports or the number and location of troops"; 2) "the primary requirements of decency . . . against obscene publications"; 3) "incitements to acts of violence and the overthrow by force of orderly government . . . . words that may have all the effect of force"; 4) "to protect private rights according to the principles governing the exercise of the jurisdiction of courts of equity." *Id.* (citations omitted).

such an infringement on free expression would not be permitted under the First Amendment.

The primary weakness in the *Near* decision results from its failure to precisely define what constitutes a "prior restraint." Absent such a definition, the path of future decisions was bound to be uncertain, and respect for the doctrine was liable to be transient. Indeed, many recent scholars have questioned whether injunctions should be treated as prior restraints at all.[296] Others have argued that the entire prior restraint doctrine has become "so far removed from its historic function, so variously invoked and discrepantly applied, and so often deflective of sound understanding, that it no longer warrants use as an independent category of First Amendment analysis."[297]

III. Using History to Define Prior Restraints

With an accurate understanding of the doctrine's history, a precise and clear definition of "prior restraint" is finally possible. An appropriate starting point is Justice Story's description of liberty of the press: "[N]either the courts of justice, nor other persons, are authorized to take notice of writings intended for the press; but are confined to those, which are printed."[298] This description accurately captures the reality that the dangers of prior restraints can come from either judges or licensors. The description is not complete, though, because it overlooks the difference between restraints emanating from "the courts of justice" and those emanating from "other persons." Specifically, the description omits the fundamental difference between restraints imposed by the judicial as opposed to the executive branch of government.

The critical element of finally solving the puzzle of defining prior restraints is the recognition that the *same* constitutional harm will necessitate *different* safeguards, when different branches of government can inflict the injury. The evil of prior restraints can be inflicted by both the executive branch, through the discretionary granting of permits or the creation of licensing boards, and the judicial branch, through issuing injunctions. However, in a system of government where the judiciary is supreme, the methods for dealing with judicial encroachment on freedom must be different from those for preventing executive encroachment. In particular, one of the primary ways to prevent executive overreaching is with judicial review. By contrast, the fundamental protection against judicial overreaching in our constitutional system is structural: Judicial action is limited to a specified role at a specified time in any particular case. The court does not resolve disputes that it institutes itself, only those brought by

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296. *See* Jeffries, *supra* note 3, at 419-20; Scordato, *supra* note 2, at 30. Not all commentators are ready to give up on the prior restraint doctrine. *See, e.g.*, Blasi, *supra* note 3, at 11; Hunter, *supra* note 3, at 293-95.

297. Jeffries, *supra* note 3, at 437; *see also* Note, *supra* note 3, at 1006 (stating that "[w]hatever the value of the prior restraints doctrine in the past, it has outlived its usefulness").

298. Story, *supra* note 123, § 1879, at 737.

either the executive branch or private parties.[299]

The concept of "prior restraint," thus, has two distinct components: one temporal, the other embodying the principle of separation of powers. This is not the separation of powers principle that was at stake in the *Pentagon Papers* case, involving congressional authorization of presidential activity.[300] Rather, this is the literal separating of power, envisioned by Madison and Montesquieu:

> "When the legislative and executive powers are united in the same person or body," says [Montesquieu], "there can be no liberty, because apprehensions may arise lest *the same* monarch or senate should *enact* tyrannical laws to *execute* them in a tyrannical manner." Again: "Were the power of judging joined with the legislative, the life and liberty of the subject would be exposed to arbitrary control, for *the judge* would then be *the legislator*. Were it joined to the executive power, *the judge* might behave with all the violence of *an oppressor*."[301]

Each branch has a specifically delineated, independent role before punishment is inflicted. The "prior" in the prior restraint doctrine refers not only to regulatory activity which is undertaken before the specific expression is communicated, but also when the executive or judicial branch acts out of its "constitutional order" vis-à-vis the other branches of government.

It is easier to understand what is meant by a prior restraint by starting with an illustration of a permissible *subsequent punishment*. This in no way contradicts the reality that in a free society most restrictions on speech, whether prior restraint or subsequent punishment, are unconstitutional. Because the doctrine of prior restraint presupposes a sphere of permissible subsequent punishment, though, visualizing the distinction is essential.[302] In those limited cases where a subsequent punishment, is permitted, it must follow the traditional time line:[303] First, the legislature enacts a general law, defining the prohibited speech or conduct. For states, this could also be a common law prohibition. Second, the speech is communicated. Third, the executive branch enforces the law by initiating legal proceedings, either through arresting the alleged law breaker or filing a complaint in court. For a private action, such as libel or invasion of privacy, the individual who is alleging harm institutes the legal proceedings. Finally, the judicial branch rules on the legality of the communication. This includes, but is not limited to, jury determinations of guilt,

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299. *See* United Pub. Workers of Am. v. Mitchell, 330 U.S. 75, 90 (1947) ("Judicial adherence to the doctrine of the separation of powers preserves the courts for the decision of issues, between litigants, capable of effective determination."); *see also* Flast v. Cohen, 392 U.S. 83, 97 (1968) ("Federal judicial power is limited to those disputes which confine federal courts to a role consistent with a system of separated powers . . . .").

300. *See* N.Y. Times Co. v. Sullivan, 403 U.S. 713 (1971).

301. THE FEDERALIST NO. 47, at 303 (James Madison) (Clinton Rossiter ed., 1961).

302. *See, e.g.*, Alexander v. United States, 509 U.S. 544, 550 (1993) (referring to "the distinction, solidly grounded in our cases, between prior restraints and subsequent punishments").

303. *Cf.* INS v. Chadha, 462 U.S. 919 (1983).

fault for libel, and community standards for obscenity. Upon a finding of illegality, the punishment for a criminal offense is imprisonment or a fine and damages for a civil violation.

Fundamentally, therefore, the only permissible governmental activity restricting speech prior to communication is that of the legislature creating a general rule applying to all speakers.[304] Such a rule, subject to the substantive limits of the First Amendment, could penalize such areas as defamation, obscenity, and breaches of the peace. There is no role for either the executive branch or the judicial branch in the creation of a general rule; both are barred from taking action on expression before communication.

Once expression is communicated, the legislature, of course, has no further role. The next governmental actor is the Executive Branch; police may arrest and prosecutors or government attorneys may file complaints. In the case of private causes of action, such as defamation, private citizens may initiate lawsuits.

Finally, in response to these filings, the courts may hear the case. With the jury making the appropriate decisions, the courts rule directly on whether the expression is constitutionally protected and whether it violated the law.

With this structure in mind, we can finally give a two-part definition for prior restraint: (1) A "prior restraint" occurs whenever judges or executive branch personnel are authorized to take notice of specific expression intended for communication, rather than that which has actually been communicated; (2) For those rare cases when the Constitution permits the regulation of expression before it is communicated, a "prior restraint" also occurs if the judiciary can initiate enforcement or the executive can make a final determination of illegality.

The connection between separation of powers and the prior restraint doctrine can be completed by noting that there is one way for the legislative branch to impose a prior restraint directly. It could correctly be considered a prior restraint were the legislature to enact a law directed at silencing a particular speaker or banning a particular publication.[305]

In summary, the doctrine of prior restraints restricts the ability of all three branches of government to regulate expression. Each branch is prohibited from either: (a) restricting specific speech or speakers prior to communication, or (b) formulating or implementing rules on speech other than in that branch's appropriate constitutional chronological order.

The vast majority of Supreme Court cases dealing with prior restraints fits comfortably within this definition. Injunctions such as those preventing the publication of the Pentagon Papers,[306] or of "facts 'strongly implicative' of [an]

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304. Obviously, the general rule must precede the communication. If a general rule was applied to communication that had already occurred, it would be an unconstitutional *ex post facto* law.

305. For examples of such legislative prior restraints, see *supra* notes 148-53, 270-77 and accompanying text. Legislative action of this sort might also be regarded as an unconstitutional bill of attainder.

306. *See* N.Y. Times Co. v. United States, 403 U.S. 713 (1971).

accused,'"[307] would still be unconstitutional prior restraints. Because licensing schemes that give discretion to regulate expressive activity without "reasonable and definite standards for the officials to follow"[308] prevent meaningful judicial review, they, too, would still be deemed unconstitutional prior restraints. Moreover, the procedural safeguards of *Freedman v. Maryland*,[309] would still be viewed as essential to prevent the dangers of a censorship system.[310]

Certain restrictions, though, would not be treated as "prior restraints." For example, judicial orders limiting the speech of trial participants and of persons while they are inside the courtroom are so fundamentally different from classic prior restraints, such as restrictions against the media covering the trial, that they should not be considered prior restraints.[311] Because of the "inherent 'equitable powers of courts of law over *their own process*, to prevent abuses, oppression, and injustices,'"[312] restrictions inside the courtroom and applied against trial participants do not threaten the separation of powers.

Similarly, many governmental employers, such as the Central Intelligence Agency, require their employees obtain permission before communicating with the public.[313] While some courts have evaluated the constitutionality of such requirements against the "general presumption against prior restraints on speech,"[314] the restrictions on speech imposed by the executive branch on its own

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307. Neb. Press Ass'n v. Stuart, 427 U.S. 539, 541 (1976) (quoting the respondent judge).

308. Niemotko v. Maryland, 340 U.S. 268, 271 (1951).

309. Freedman v. Maryland, 380 U.S. 51 (1965).

310. *See id.* at 58-59.

311. Numerous cases from lower federal courts and state courts can be found on both sides of the question of whether to term these orders "prior restraints." *See* United States v. Salameh, 992 F.2d 445, 446-47 (2d Cir. 1993); Chase v. Robson, 435 F.2d 1059, 1061 (7th Cir. 1970); Breiner v. Takao, 835 P.2d 637, 640-41 (Haw. 1992); Kemner v. Monsanto Co., 492 N.E.2d 1327, 1336 (Ill. 1986); Twohig v. Blackmer, 918 P.2d 332 (N.M. 1996); Davenport v. Garcia, 834 S.W.2d 4, 9-11 (Tex. 1992) (finding such an order to be a prior restraint). *But cf.* Radio & Television News Ass'n of S. Cal. v. U.S. Dist. Court for the Cent. Dist. of Cal., 781 F.2d 1443, 1446 (9th Cir. 1986); Chi. Council of Lawyers v. Bauer, 522 F.2d 242, 248 (7th Cir. 1975) (finding such orders not to be a prior restraint). Some courts have even treated the exact same order as a prior restraint if challenged by the gagged party, but not if challenged by the media. *See e.g.*, Dow Jones & Co. v. Simon, 842 F.2d 603, 609 (2nd Cir. 1988). *Contra* CBS, Inc. v. Young, 522 F.2d 234, 239 (6th Cir. 1975).

312. Seattle Times Co. v. Rhinehart, 467 U.S. 20, 35 (1984) (quoting Int'l Prods. Corp. v. Koons, 325 F.2d 403, 407-08 (2d Cir. 1963) (quoting Gumbel v. Pitkin, 124 U.S. 131, 145-46 (1888)) (emphasis added)).

313. *See, e.g.*, Snepp v. United States, 444 U.S. 507 (1980) (upholding requirement that CIA employees obtain the Agency's prior approval before publishing information about the CIA); Harman v. City of New York, 140 F.3d 111 (2d Cir. 1998) (striking down ban prohibiting employees of the Administration for Children's Services from speaking with the media regarding any activities of the agency without first obtaining permission from the agency's media relations department).

314. *Harman*, 140 F.3d at 119; *see also* Zook v. Brown, 865 F.2d 887, 890 (7th Cir. 1989) (upholding a regulation despite it being "a prior restraint on the free speech of a public employee");

employees do not present the separation of powers difficulties of traditional prior restraints. Restrictions imposed in furtherance of the interests of "an employer in regulating the speech of its employees"[315] simply do not encroach on the law-making function of the legislative branch.

Although judicial orders against trial participants and government employment contracts should not be considered "prior restraints," they are still subject to the stringent commands of the First Amendment. The Supreme Court held that a ban on disclosing discovery information needed to further a "substantial governmental interest unrelated to the suppression of expression," and must limit, "First Amendment freedoms no greater than is necessary."[316] Similarly, courts uphold limits on the speech of government employees if the speech interests both of employees and of their potential audiences are "outweighed by that expression's 'necessary impact on the actual operation' of the Government."[317] The prior restraint doctrine is not the only means to protect free expression.

Conclusion

There is much to be learned from the neglected history of the prior restraint doctrine. From English common law, to colonial times, to the drafting of the First Amendment, it was understood that no government official was to have power over speakers prior to communication. Throughout the Nineteenth century, judges equated injunctions against defamatory statements with prior restraint and equated prior restraints with the absence of freedom. Thus, the Supreme Court correctly held in *Near* that an injunction against speech should be treated as a prior restraint.

The most important lesson from history, though, is the need to incorporate the concept of separation of powers into the definition of prior restraints. The evil of prior restraints can be caused by different branches of government, the judicial as well as the executive branch. The structure of our constitutional system provides different safeguards for preventing each branch from abusing its power. With a proper definition of "prior restraint," we will be able to ensure that prior restraints are forever treated as "the most serious and the least tolerable infringement on First Amendment rights."[318]

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prior restraint"); Spain v. City of Mansfield, 915 F. Supp. 919, 923 (N.D. Ohio 1996); Zook v. Brown, 865 F.2d 887, 890 (7th Cir. 1989) (upholding a regulation despite it being "a prior restraint on the free speech of a public employee") (same).

315. Pickering v. Bd. of Educ., 391 U.S. 563, 568 (1968).

316. *Seattle Times*, 467 U.S. at 32 (quoting Procunier v. Martinez, 416 U.S. 396, 413 (1974)).

317. United States v. Nat'l Treasury Employees Union, 513 U.S. 454, 468 (1995) (quoting *Pickering*, 391 U.S. at 571) (striking down a ban on federal employees receiving honoraria for appearances, speeches, or articles). This balancing test applies only when the employee speaks "as a citizen upon matters of public concern" rather than "as an employee upon matters only of personal interest." Connick v. Myers, 461 U.S. 138, 147 (1983).

318. Neb. Press Ass'n v. Stuart, 427 U.S. 539, 559 (1976).

FATHER (OR MOTHER) KNOWS BEST: AN ARGUMENT AGAINST INCLUDING POST-MAJORITY EDUCATIONAL EXPENSES IN COURT-ORDERED CHILD SUPPORT

JUDITH G. MCMULLEN*

INTRODUCTION

College, or technical training, has become a rite of passage for the majority of young people who aspire to be a part of the middle class. Every year, thousands of students begin post-high school education at a variety of colleges, universities and technical schools. Pursuing higher education is an important part of the American Dream for many people. However, educational costs have risen at a rate far outpacing inflation. Post-high school education is unattainable for many students without help from their parents, scholarships, loans, or all three.

This Article examines the nature of post-high school education[1] and discusses whether parents who have divorced should ever be required to pay for the education of the offspring of their failed marriage. As of this writing, only a handful of states empower judges to order payment of post-majority educational expenses.[2] Most states provide for imposition of child support obligations only until the child reaches age eighteen. Sometimes this is extended to age nineteen if the child is still attending high school full-time.[3] Parents are free to enter settlement agreements or other contracts to provide college expenses for their children, and those agreements will be enforced (or not) according to the principles of contract law.[4] However, parents of intact families can choose to provide college expenses or not, and many divorced parents are opposed to the policy of requiring them to provide what their married counterparts need not.

This Article concludes that the law should not force divorced parents to contribute to the post-majority education of their children. This conclusion is based on the nature of the transfer of funds from parents to children for the purpose of providing those children with higher education. In current society, payment of college and similar expenses is regarded as a wholly voluntary and gratuitous transfer from parent to child. More than a decade ago, Professor John H. Langbein wrote an article in which he argued that the character of family

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1. While the thesis of this Article applies to all forms of post-majority education, such as college and technical training of various sorts, most of the specific references have to do with college education. This is partly because that is how the issue usually comes up in cases and articles, and partly because the large expenses associated with college make it an especially dramatic example of the economic issues to be discussed.

2. *See infra* text accompanying notes 23-46.

3. *See, e.g.*, WIS. STAT. § 767.25(4) (1998).

4. *See infra* text accompanying notes 48-54.

wealth transmission had changed dramatically in the late Twentieth Century.[5] He claimed that rather than amassing fortunes to be inherited by their offspring, middle class parents now pass wealth along to the next generation by investing in children's skills and education. "Education is displacing inheritance," he said, and "lifetime transfers are displacing succession on death."[6] If, as Langbein suggests, the main form of inter-generational wealth transfer is indeed accomplished through parental investment in the education of their children, then court-imposed payments for higher education do not just provide another form of child-support, they amount to a form of forced heirship. Since parents are almost universally free to disinherit their children, parents should be equally free to refuse to pay for a college education.[7]

Part I of this Article explores the social and financial picture surrounding college expenses and discusses the current law concerning court-ordered payment of post-majority educational expenses by divorced parents. Part II of this Article further discusses Professor Langbein's characterization of educational investments as a form of inter-generational wealth transmission, and explains how his theory is relevant here. The tradition of allowing parents to disinherit their children is also discussed. Next, Part III develops the argument that allowing divorced parents to decide whether to contribute to their children's college education advances many of the positive goals sought in giving parents the freedom to disinherit their children and is consistent with legitimate goals in family law and in the law of inheritance. Finally, Part IV addresses some counterarguments to my thesis and then ends with a summary and conclusion.

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5. *See* John H. Langbein, *The Twentieth-Century Revolution in Family Wealth Transmission*, 86 MICH. L. REV. 722, 723 (1988).

6. *Id.* at 735.

7. This argument is quite different from the usual argument against forcing parents to pay for post-majority educational expenses: namely, that such a requirement would be inconsistent with other legal policies concerning children who have reached the age of eighteen. Parents in intact families are no longer legally obligated to support their offspring who have attained the age of majority, although of course they are free to do so if they wish. Persons who have reached the age of majority are granted many, but not all, of the privileges and obligations of adulthood. Requiring payment of educational expenses is inconsistent with the notion of emancipation from parental control and protection and may violate principles of equal protection. *See infra* text accompanying note 114.

It could be reasonably argued that eighteen is an unrealistically young age of majority, given that many persons are neither economically nor emotionally independent at that age. However, that is a subject for a different article. This Article takes eighteen as the age of majority in most states as a starting point, and goes on from there.

I. POST-MAJORITY EDUCATION AND THE IMPOSITION OF ITS COSTS ON DIVORCED PARENTS

A. Current Economic Realities Surrounding Higher Education

Formal education has assumed a position of major importance in American society, and its importance seems to grow with each passing year. When the United States shifted from a chiefly agrarian society in the Nineteenth Century, many workers flowed into industrial jobs in the towns and cities. While much emphasis has been placed on the vast differences between industrial and agrarian livelihoods, they did have one important characteristic in common: neither farm jobs nor factory jobs required book learning. Both provided work environments, as did the trades of colonial times, where the worker needed only a strong body and a willing attitude, and then learned on the job.[8] Except for "learned professions," like law, teaching and medicine, it remained possible for relatively uneducated but willing workers to earn middle class incomes well into the second half of the Twentieth Century.[9] Then everything changed.

As production became more mechanized and labor unions lost power, American industry suffered from foreign competition in the late Twentieth Century. Industrial jobs became more scarce. The jobs that remained required greater skills, including computer proficiency in many cases. Even farming changed, with the family farm increasingly losing out to big farm conglomerates run according to the principles taught in agricultural and business school.[10] Whereas previous generations could obtain and hold good jobs without even the benefit of a high school education, today's workers have menial job prospects if they have only a high school diploma.

> The futures of students who do not go to college appear dim. A forecast by the Bureau of Labor Statistics . . . predicts that while demands for workers with even a little college will increase, demands for workers with only a high school diploma will decline—and the jobs offered will not likely be permanent. Steady jobs with career prospects are in decline, while part-time, temporary, and contract employment, all of which lack job security, are on the rise. . . . Recent labor market studies characterize young workers with few educational credentials as floundering from one short-term job to another.[11]

Technical training, trade school, college, and even post-graduate education are essential for most jobs currently capable of funding a middle class standard of living. Persons without this training are often relegated to low-paying jobs in the service sector. In *No Shame in My Game*, anthropologist Katherine S.

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8. *See* Langbein, *supra* note 5, at 725.

9. *Id.*

10. *See id.* at 727-28.

11. KATHERINE S. NEWMAN, NO SHAME IN MY GAME: THE WORKING POOR IN THE INNER CITY 342 n.2 (1999) (citations omitted).

Newman examines the situation of over 300 residents of Harlem and Washington Heights. Although many of these people had graduated from high school, they were "working poor": employed persons trapped in poverty that their minimum wage jobs could not eliminate. One man, William, commented ruefully on the relationship between education and better opportunities:

> Nowadays a basic education is almost obsolete. When I was growing up in the seventies all you needed was basically a high school diploma and you would do just fine. If you had a bachelor's degree, you were the man. A master's, you were the epitome. Nowadays you need a Ph.D. just to break even. And a master's just says you tried extra hard. That's about it.[12]

William added: "You have a high school diploma, . . . you may as well stay at Burger Barn, 'cause that's as far you gonna go unless you get lucky and know somebody."[13]

A parent working full-time in a minimum wage job cannot keep a family of four out of poverty. Even two parents working full time in minimum wage jobs will generate annual income far below the current median household income.[14] The picture is bleak indeed for the undereducated.

For many, the zenith of hope for a better education is represented by a college degree. "The market for higher education is so robust," said Lawrence Gladieux, executive director for policy analysis at the College Board, a national non-profit organization that does an annual survey of college costs.[15] "People know that the best life chances and jobs come through college education."[16]

At the same time post-secondary education became more important, it became significantly more expensive, at a rate outpacing inflation. Tuition increased by double digit percentages throughout the 1980s and early 1990s, and by the late 1990s the cost of a college education rose about four or five percent per year.[17] "Since 1980, the average tuition at four-year institutions has more than doubled after adjusting for inflation, while the median family income for the

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12. *Id.* at 139.

13. *Id.*

14. This can be illustrated with data from the Census Bureau report for 1998, as reported in the *New York Times*. *See* Louis Uchitelle, *Rising Incomes Lift 1.1 Million out of Poverty*, N.Y. TIMES, Oct. 1, 1999, at A20. A worker employed forty hours a week for fifty-two weeks a year would earn a gross income of $10,712. This is significantly below the 1998 poverty line income of $16,655 for a family of four. Even if both parents work full time for minimum wage, the resulting family income of $21,424 is far below the 1998 median household income of $38,885. Median household income includes even one person households, however. When the $21,424 income is compared to the 1998 median *family* income of $46,737, the picture is even bleaker. *See id.*

15. Ethan Bronner, *College Tuition Rises 4%, Outpacing Inflation*, N.Y. TIMES, Oct. 8, 1998, at A18.

16. *Id.*

17. *See id.*

parents of college-age children has increased just [twelve] percent."[18] Data released by the College Board shows that for the 1998-1999 school year, tuition and fees averaged $3243 at four-year public institutions, and averaged $14,508 at private four-year colleges.[19] These figures prompted Donald M. Stewart, president of the College Board, to comment: "The cost of attending college presents a steadily rising challenge to many Americans, particularly the most financially disadvantaged."[20]

However, other factors make the college accessibility picture less bleak. In fact, there is a wide variety of financial aid available. While some of the aid is based on merit, nearly eighty percent is need-based.[21] While high-priced schools like Bennington or Yale may terrify prospective students and their parents with their high price tags, "nearly seventy percent of four-year undergrads opt for lower-cost public universities. . . . What's more, a growing number of public universities, unwilling to lose their best students to another state, give qualified residents a free or near-free ride."[22] Thus, even students who are at a financial disadvantage have a realistic opportunity to obtain a college education, with all of its attendant benefits.

B. Current Law Concerning Imposition of College Expenses on Divorced Parents

A number of states have specific cases or statutes that provide for the possibility of imposition of post-majority college expenses on one or both parents, where their marriage has ended in divorce.[23] Other states, while authorizing no outside imposition of such obligations, will nonetheless enforce

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18. Ben Wildavsky, *Paying for College: Is that the Real Price?*, U.S. NEWS & WORLD REP., Sept. 6, 1999, at 64.

19. *See* Bronner, *supra* note 15, at A18.

20. *Id.*

21. *See* Wildavsky, *supra* note 18, at 70.

> A new study by University of Michigan researchers Donald Heller and Thomas Nelson Laird found that [seventy-eight] percent of the grant money awarded by four-year colleges and universities in 1995 was need based. While spending on merit grants grew substantially, rising [ninety-seven] percent between 1989 and 1995, need awards grew even faster, rising 114 percent over the same period.

Id.

22. *Id.* at 64-65.

23. *See* Linda D. Elrod & Robert G. Spector, *A Review of the Year in Family Law: Century Ends with Unresolved Issues*, 33 FAM. L.Q. 865, 910 (2000). According to Elrod and Spector, college expenses may currently be imposed on divorced parents in Alabama, Alaska, the District of Columbia, Hawaii, Illinois, Indiana, Iowa, Massachusetts, Michigan, Missouri, New Hampshire, New Jersey, New York, Oregon, South Carolina, Tennessee and Washington. In addition, two other states, North Dakota and Colorado, have laws indicating that a court could order post-majority support in appropriate circumstances. *See* Donarski v. Donarski, 581 N.W.2d 130 (N.D. 1998); *see also infra* text accompanying notes 35-40.

private agreements between the parents.[24] No state currently has a formal incentives program, but courts may make *de facto* adjustments in other obligations where college expenses have been awarded.[25] Most states end child support obligations when a child turns eighteen, although many states will extend the payment period to age nineteen if the child is still a full-time high school student.[26] Married parents cannot be forced to pay post-majority educational expenses for their offspring.[27]

Perhaps the most straightforward justification for allowing court-ordered child support is a system that regards college students as dependents of their parents. An example of this approach can be found in the law of Washington D.C. where, for purposes of child support, a person remains a child until age twenty-one.[28] Thus, college expenses, like any educational expenses incurred by a child, are a proper use of child support payments. New Jersey law uses a similar justification, namely that emancipation occurs as the result of some event that makes the child self-supporting, and is not purely age-based.[29] One New Jersey court coined the term "unemancipated adult" to describe this phenomenon.[30]

Sometimes, ordering payment for post-majority educational expenses is viewed as a permissible exercise of a family court's legitimate powers to allocate property and provide for reasonable support of children whose parents are divorcing. In *Ex parte Bayliss*,[31] the Alabama Supreme Court held that where a marriage was terminated by divorce, a court could use its equity powers to extend parental support obligations beyond the age of majority. The court held that when determining the appropriateness of post-minority support for college education, the trial court is required to consider "all relevant factors that shall appear reasonable and necessary, including primarily the financial resources of the parents and the child and the child's commitment to, and aptitude for, the requested education."[32] The court suggested, but did not require, that the trial court also consider other relevant factors, namely "the standard of living that the child would have enjoyed if the marriage had not been dissolved and the family unit had been preserved and the child's relationship with his parents and

24. *See, e.g.*, Steffes v. Steffes, 560 N.W.2d 888 (N.D. 1997).

25. For example, a court may be more reluctant to award alimony, or may award a lesser amount, where the payor is already saddled with child support and college expenses.

26. *See* LESLIE J. HARRIS & LEE E. TEITELBAUM, FAMILY LAW 600 (2d ed. 2000).

27. *See, e.g.*, Childers v. Childers, 575 P.2d 201 (Wash. 1978) (en banc), *cited in* HARRIS & TEITELBAUM, *supra* note 26, at 593.

28. *See* D.C. CODE ANN. § 30-401 (1999); *see also* Butler v. Butler, 496 A.2d 621, 622 (D.C. 1985) (per curiam).

29. *See* Sakovits v. Sakovits, 429 A.2d 1091, 1093-94 (N.J. Super. Ct. Ch. Div. 1981).

30. *See* James G. O'Donohue, *Back to School: The Nearly Unavoidable Responsibility for College Expenses*, 149 N.J. L.J. 745 (1997) (quoting Blum v. Ader, 652 A.2d 176, 177 (N.J. Super. Ct. App. Div. 1994)).

31. 550 So. 2d 986 (Ala. 1989).

32. *Id.* at 987.

responsiveness to parental advice and guidance."[33] It appears from subsequent Alabama cases that the *Bayliss* standards are applied rather liberally to favor a child who is requesting college support.[34]

A North Dakota case, *Donarski v. Donarski*,[35] provides another example of court-ordered college support based on the general discretionary power of the court. The court held that its statutory discretion to order payment of post-minority support included the power to award college expenses in appropriate circumstances.[36] The relevant statutory section deals primarily with the authority of the court to order support past age eighteen when the child is living at home and is still enrolled in high school. The statute also provides that "[t]his section does not preclude the entry of an order for child support which continues after the child reaches age eighteen, if the parties agree, *or if the court determines the support to be appropriate*."[37] The court's finding that it had the power to order college support was apparently based on this language, as well as North Dakota precedent that pre-dated this version of the statute. However, Chief Justice VandeWalle and Justice Sandstrom dissented from this section of the opinion. "The language 'does not preclude' is not a grant of authority," said Justice Sandstrom.[38] He went on to question the court's reliance on Alabama and New Jersey precedent:

> While both of these states have general support statutes similar to ours, both the Alabama and New Jersey courts have interpreted children to mean dependent children, even if over the age of majority. . . . For us to reach this result, however, we must ignore N.D.C.C. § 14-10-01, which states the term "child" means "minor" and a minor is a person under [eighteen]. . . . Apparently, the Alabama and New Jersey courts were not so bound.[39]

Several states have statutes that specifically grant judges discretion to order parents to pay post-secondary educational expenses in appropriate circumstances. For example, Colorado judges are authorized to terminate ordinary child support payments and instead issue an order "requiring both parents to contribute a sum determined to be reasonable for the education expenses of the child, taking into

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33. *Id.*

34. *See, e.g.*, Kent v. Kent, 587 So. 2d 409, 412 (Ala. Civ. App. 1991). Here, the appellate court upheld a trial court order that required the father to pay tuition, books, and some support while his son was enrolled in college. This order was upheld despite the fact that the father was not wealthy and had concerns about being laid off. Moreover, the father and son had no real relationship with each other, and the son had achieved only a "C" average in his first quarter college grades.

35. 581 N.W.2d 130 (N.D. 1998).

36. *See id.* at 135-36; N.D. CENT. CODE § 14-09-08.2(6) (1999).

37. N.D. CENT. CODE § 14-09-08.2(6) (1999) (emphasis added).

38. *Donarski*, 581 N.W.2d at 139 (citation omitted).

39. *Id.* at 140 (internal citations omitted).

account the resources of each parent and the child."[40] The Iowa Code provides that a "court may order a postsecondary education subsidy if good cause is shown."[41] Another example can be found in the Indiana Code which provides that "[t]he child support order or an educational support order may also include, where appropriate: (1) amounts for the child's education in elementary and secondary schools and at institutions of higher learning."[42]

Whether states authorize post-majority support orders by statute or by common law, there are some limits placed on the amount a court may order. The Colorado statute limits each parent's contribution "to an amount not to exceed the amount listed under the schedule of basic child support obligations in paragraph (b) of subsection (10) of this section for the number of children receiving postsecondary education."[43] The Iowa statute directs the court to base the cost of postsecondary education on only necessary costs "of attending an in-state public institution for a course of instruction leading to an undergraduate degree."[44] Cases and statutes alike require courts to assess the appropriateness of a college support order on factors such as the child's abilities[45] and the financial situations of the child and the parents.[46] Courts "may also consider the standard of living the child would have enjoyed if the divorce had not occurred and the child's relationship with his or her parents."[47]

In addition,"[m]ost states will enforce an agreement of the parties."[48] "Courts generally hold that the parties may take on more extensive obligations than a court could impose on them."[49] Payment of post-secondary educational expenses may well be negotiated as part of a larger settlement agreement, and may be incorporated into the divorce judgment. In these cases, the court may use its power to both interpret and enforce the terms of the agreement. For example,

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40. COLO. REV. STAT. ANN. § 14-10-115(1.5)(b)(I) (West 2000).

41. IOWA CODE § 598.21(5A) (2000).

42. IND. CODE ANN. § 31-16-6-2(a)(1) (2000).

43. COLO. REV. STAT. ANN. § 14-10-115(1.5)(b)(I) (West 2000).

44. IOWA CODE § 598.21(5A)(a)(1) (2000).

45. *See e.g., id.* § 598.21(5A)(a); DeLong v. DeLong, 315 N.E.2d 412, 417 (Ind. App. 1974) (citing IND. CODE § 31-1-12-15 (1971)); Donarski v. Donarski, 581 N.W.2d 130, 136 (N.D. 1998) (citing Newburgh v. Arrigo, 443 A.2d 1031, 1038-39 (N.J. 1982)).

46. *See, e.g.*, COLO REV. STAT. ANN. § 14-10-115(1.5)(b)(I) (West 2000); IOWA CODE § 598.21(5A)(a) (2000); Baggett v. Foster, 622 So. 2d 350, 351 (Ala. Civ. App. 1992) (citing *Ex parte* Bayliss, 550 So. 2d 986 (Ala. 1989)).

47. *Baggett*, 622 So. 2d at 351 (citing *Ex parte Bayliss*, 550 So. 2d at 986).

48. Linda D. Elrod et al., *A Review of the Year in Family Law: Children's Issues Dominate,* 32 FAM. L.Q. 661, 714 n.2 (1999).

49. HARRIS & TEITELBAUM, *supra* note 26, at 720. The authors intended their statement to cover family contracts generally, but chose a post-majority support case as their example (citing Solomon v. Findley, 808 P.2d 294 (Ariz. 1991), *aff'g* 796 P.2d 477 (Ariz. Ct. App. 1990) (upholding an agreement to support a child during post-majority schooling, even though the Arizona court could not have ordered that behavior in the absence of an agreement)).

in *Allard v. Allard*,[50] a separation agreement, which had been incorporated into the judgment, provided that the husband would "pay for a four-year college education for each of the children at a Missouri state-supported university which include room, board, tuition, books, college incidentals, and said child's necessary clothing."[51] When their older son entered college, the father refused to pay. The mother brought suit to enforce the separation agreement. After accepting evidence of the exact cost of the son's tuition, room and board, books and clothes, and after taking account of grants received by the son, the trial court ordered the father to pay the balance due for the son's freshman year.[52] The appellate court upheld the trial court's decision, noting that "[s]eparation agreements in anticipation of dissolution, if not unconscionable, are now binding on the court. When incorporated into the judgment, they are 'enforceable by all the remedies available for enforcement of a judgment.'"[53] The court rejected the father's argument that the agreement to provide college support was vague and therefore unenforceable, stating "[o]ur opinion determines that the agreement for child support incorporated into the judgment was amenable to being made certain by evidence, and was made certain and enforceable."[54] Thus, even fairly broad or general contracts to pay will be interpreted and enforced when actual expenses are presented.

II. Inheritance, Disinheritance, and the American Child

A. The Revolution in Family Wealth Transmission According to Langbein

In his 1988 article, *The Twentieth-Century Revolution in Family Wealth Transmission*, John Langbein said "[f]undamental changes in the very nature of wealth have radically altered traditional patterns of family wealth transmission, increasing the importance of lifetime transfers and decreasing the importance of wealth transfer on death."[55] To support this claim, Langbein develops two themes. First, he describes the shift from a pattern of parent-child wealth transmission wherein the wealth consisted of a farm or business, to a pattern where wealth transmission centers on the parents' investment in children's skills.[56] Second, Langbein points out that the same parents who invest much of their wealth in the education of their offspring are also living much longer than did parents in previous generations. The expenses associated with the parents' old age reduce any remainder that might otherwise be inherited.[57]

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50. 856 S.W.2d 64 (Mo. Ct. App. 1993).

51. *Id.* at 65 (quoting a term of the separation agreement).

52. *See id.* at 66.

53. *Id.* at 69 (citing Bryson v. Bryson, 624 S.W.2d 92, 96 (Mo. Ct. App. 1981); Mo. Rev. Stat. § 452.325.5 (1986)).

54. *Id.* at 70 n.8.

55. Langbein, *supra* note 5, at 722.

56. *See id.* at 723.

57. *See id.* Langbein points out that this depletion of the parent's estate is exacerbated by

Langbein notes that in previous times, transfer of the family farm or family business would give children a means of earning a living and consequent protection from living out their lives in menial servitude to someone else.[58] "In today's economic order, it is education more than property, the new human capital rather than the old physical capital, that similarly advantages a child."[59] Langbein does not restrict his thesis to college education, noting that "[t]he process of delivering educational advantage to children begins when they are very young."[60] He cites preschool education, private schools, and moves to better school districts for primary and secondary schools as examples of parental investment in education.[61] College, with its huge and ever-rising costs, is an even clearer illustration of his thesis. Langbein cites a 1987 story in *Newsweek*, which figured the annual undergraduate tuition and fees at Johns Hopkins for that year at $15,410, a figure which Langbein points out constitutes thirty-one percent of an annual family income of $50,000.[62]

> Now it is quite obvious that very few families can afford to pay thirty-one percent of family income, or anything near it, on what we would call—in an accounting sense—a current basis. That is especially true when the family has more than one child in the educational mill at the same time. For most families, therefore, these education expenses represent capital transfers in a quite literal sense. The money comes from savings, that is, from the family's capital or debt is assumed, meaning that the money is borrowed from the family's future capital.[63]

Langbein points out that the guidelines for financial aid used by universities explicitly consider all family wealth, and not just income.[64] "[T]he greater the family wealth, the higher the fraction that the parents are expected to transfer to the child in support of the child's education."[65] Langbein cites an example from the *Newsweek* article, a parent named Mr. Lu, who refinanced his mortgage, sold some investments, and took out loans to pay for one son to attend Princeton and another son to attend Harvard Law School. "I've told my sons," Mr. Lu said, "your education is going to be your inheritance."[66]

Langbein concedes that his thesis applies most readily to the middle class, since the very wealthy will likely have plenty left over to inherit after both the

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characteristics of pension funds, especially "the bias toward annuitization. When wealth is annuitized, virtually nothing is left for transfer on death." *Id.* at 724.

58. *See id.* at 732.

59. *Id.* at 732-33.

60. *Id.* at 733.

61. *See id.*

62. *See id.* at 734 (citing Harry Anderson et al., *Fuming Over College Costs*, NEWSWEEK, May 18, 1987, at 66).

63. *Id.*

64. *See id.* at 734-35.

65. *Id.* at 735.

66. *Id.* (citing Anderson et al., *supra* note 62, at 67).

costs of their children's education and the costs of retirement, and the poor have neither the money required for college nor any estate for their children to inherit.[67] However, he claims that a change in attitude towards wealth is present even among the rich. He cites Warren Buffett and Eugene Lang as examples of wealthy men who have stated that they will disinherit their children so that the children can make it on their own.[68] "[T]he disdain for customary modes of wealth transfer that Messrs. Buffett and Lang are voicing presupposes that these gentlemen have already achieved for their children the characteristic wealth transfer of modern times, the investment in human capital through education," Langbein says.[69] He concludes: "More and more, Americans expect personal wealth to take the form of earned income, that is, we expect it to be a return on human capital."[70]

Langbein's thesis is just as true today as it was when he wrote the article over a decade ago. The average tuition and fees cited earlier in the article are no more affordable to a family earning $50,000 annually than they were in the late 1980's.[71] Post-high school education is as important as ever.

Why then would I argue that any parents, divorced or still-married, have the right to refuse to finance this important benefit for their children? Simply because I agree with Langbein that education is a form of intergenerational wealth transfer, or inheritance, and in this country, testators are practically unfettered in their ability to disinherit their children.[72]

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67. *See id.* at 724.

68. *See id.* at 737-38.

69. *Id.* at 738.

70. *Id.*

71. However, the competition for good students has made at least some schools more responsive to the financial stresses of families. For example,

> [i]n January 1998, Princeton University announced that for most families with incomes below $90,000, the school would no longer consider the value of the family's home when calculating ability to pay. Middle-income students could also expect more grants and fewer loans. MIT and Stanford, among other schools, have followed with similar measures.

Wildavsky, *supra* note 18, at 68.

More recently, Princeton announced that it would provide scholarships in lieu of loans to undergraduates who are eligible for financial aid so that students "would not have to worry about paying back thousands of dollars for their education." Karen W. Arenson, *Princeton to Replace Loans with Student Scholarships*, N.Y. TIMES, Jan. 28, 2001, at 24.

72. It is, to be fair, an open question whether the right to disinherit children, even minor children, should be quite so unfettered. However, it does seem that the law should be consistent across similar situations, and it is the contention of this Article that similar considerations inform the decision about whether to provide college education, life-time gifts, or bequests to one's offspring.

B. Disinheriting the American Child

In the United States, it is perfectly legal for a parent to disinherit his child.[73] "Under the banner of freedom of testation, American inheritance law permits disinheritance of even the decedent's closest family dependents. Indeed, in most states today parents can disinherit minor, disabled, and unborn children without cause or remedy."[74]

In general, a parent may disinherit a child by expressly stating an intent to do so and by completely disposing of his estate to other persons.[75] Even these requirements are not solely meant to discourage disinheritance, but rather to assure that it is what the testator intended[76] and to ensure that any property which is not covered by the will does not go to the child as intestate property.[77] The first requirement guards against inadvertent disinheritance, as where one child's name is accidentally omitted from the final will draft. The second requirement assures that property does not reach the child through intestate succession, which governs whenever a will does not effectively dispose of all the decedent's property.

Courts uphold parental disinheritance of offspring, unless there is evidence of fraud or lack of testamentary capacity. However, the law favors testamentary gifts to offspring as a matter of policy, so it is fair to say that courts are generous in interpreting ambiguous circumstances in favor of the children. "A testator . . . may bequeath his entire estate to strangers, to the exclusion of his wife and children, but in such case the will should be closely scrutinized, and upon the slightest evidence of aberration of intellect, or collusion or fraud, or any undue influence or unfair dealing, probate should be refused."[78] Nonetheless, disinheritance of a child is far from conclusive proof of lack of testamentary capacity. "[A] parent may, in his will, disinherit a child without laboring under an insane delusion."[79] If a will can survive contest, the disinheritance of children

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73. Louisiana is currently the only exception to the rule that a parent can intentionally disinherit even a minor child. *See* Ralph C. Brashier, *Protecting the Child from Disinheritance: Must Louisiana Stand Alone?*, 57 LA. L. REV. 1 (1996). However, many states have so-called pretermitted heir statutes, which protect against unintentional disinheritance of children.

74. Frances H. Foster, *Linking Support and Inheritance: A New Model from China*, 1999 WIS. L. REV. 1199, 1217-18 (citations omitted).

75. *See* JESSE DUKEMINIER & STANLEY M. JOHANSON, WILLS, TRUSTS, AND ESTATES 90 (6th ed. 2000).

76. *See id.* at 536-50.

77. *See id.* at 90.

78. GA. CODE ANN. § 113-106 (1959), *cited in* Lawrence M. Friedman, *The Law of the Living, the Law of the Dead: Property, Succession, and Society*, 1966 WIS. L. REV. 340, 358-59. *See also* DUKEMINIER & JOHANSON, *supra* note 75, at 536-37 ("The law does not favor cutting children out of the parent's estate when the testator leaves no spouse. To this end, a number of doctrines have been flexibly used to protect children, with the consequence that disinheritance is almost always a risky affair. A will disinheriting a child virtually invites a will contest.").

79. Flaherty v. Feldner, 419 N.W.2d 908, 911 (N.D. 1988) (Vande Walle, J., concurring),

is perfectly legal.

Under traditional doctrine, parents can even disinherit minor children. While minor children can be disinherited, a spouse cannot be. There is an expectation that the surviving parent will continue to provide for the children, and indeed is legally obligated to do so if the children are minors. Part of this support is likely to come from the spousal share.

> Modern succession law . . . unmistakably prefers the nuclear family (and especially the wife) over more distant kin. To say that the law favors the nuclear family seems rather paradoxical at first glance, in view of the stubborn persistence of the right to disinherit children completely and without stating cause. In fact, however, disinheritance of children is both common and natural. The average man marries only once and his widow is the mother of his children. She succeeds to the husband's rights as guardian of the children and head of the family. Under these conditions, it is not "unnatural" to leave nothing to the children. The right to disinherit children survives in modern American law, whatever its antecedents, not only because of a bias in favor of freedom of testation, but because disinheritance is functional for the majority of testators. Indeed, one reason often given to convince people that they need to have a will is precisely that without one minor children share in the estate. An awkward, costly guardianship then has to be set up, and the wife's economic control of family property, even her position as head of the family, may be impaired.[80]

Despite periodic calls for reform in scholarly literature, American law has proved surprisingly resistant to inheritance laws that would offer protection against disinheritance to a child of a testator.[81] Early in American legal history, English law heavily influenced American inheritance law. However, English

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cited in Donarski v. Donarski, 581 N.W.2d 130, 140 (N.D. 1998) (Sandstrom, J., dissenting).

80. Friedman, *supra* note 78, at 362-63 (citation omitted).

81. "Scholars have sporadically focused their attention on the disinherited American child. Indeed, one of the leading writers on inheritance law indicated in 1940 that a move was unmistakably under way to limit the unfettered freedom of American testators to disinherit children." Ralph C. Brashier, *Disinheritance and the Modern Family*, 45 CASE W. RES. L. REV. 83, 84 n.4 (1994) (citing Joseph Dainow, *Limitations on Testamentary Freedom in England*, 25 CORNELL L.Q. 337, 338 (1940); Herbert D. Laube, *The Right of a Testator to Pauperize His Helpless Dependents*, 13 CORNELL L.Q. 559, 594 (1928)).

See also Foster, *supra* note 74, at 1207-17 (describing the scholarly debate about the merits, or lack thereof, of the American system, which allows such unrestricted disinheritance of children). Foster points out that scholars and reformers have borrowed heavily from foreign models to provide examples of possible reforms. *See id.* at 1208. Foster notes that scholars have placed particular emphasis on two approaches: forced heirship provisions (which give a fixed, minimum percentage of the estate to certain family members, such as the decedent's spouse or offspring), and family maintenance systems (which allow a court to alter a will or intestate distribution so as to address the needs of a decedent's dependents). *See id.* at 1210-11.

rules that protected children from complete disinheritance never caught on here. Until the Fourteenth Century, English law guaranteed children a forced share of a decedent's chattels.[82] With respect to real property, the doctrine of primogeniture protected the testator's eldest living son.[83] Despite a brief flirtation with forced shares in personalty, the American states rejected the approach.[84] Likewise, primogeniture was "never cordially received in this country."[85] Perhaps American states rejected these rules for the same reasons that Blackstone surmised caused English law to eventually abandon them:

> [T]he children or heirs at law were incapable of exclusion by will. Till at length it was found, that so strict a rule of inheritance *made heirs disobedient and headstrong*, defrauded creditors of their just debts, and prevented many provident fathers from dividing or charging their estates, as the exigencies of their families required.[86]

There has been much scholarly discussion of the reasons U.S. law is so tolerant of the disinheritance of children, despite the fact that many, if not most developed countries prohibit the complete disinheritance of offspring.[87] In cases where there is no proof of fraud or undue influence, American law has a number of reasons for allowing testators to disinherit their own children.

For one thing, freedom of testation, or the right to dispose of one's own property as one wishes, is given great weight in the law of wills. As I have pointed out elsewhere, estate planning in the United States today indulges the plans and whims of property owners.[88] Potential beneficiaries of a person's estate have no ownership rights to his property while he is alive, and no absolute

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82. *See* Brashier, *supra* note 81, at 113-14. Brashier notes that while the right had almost disappeared by the end of the Fourteenth Century, it lasted longer in some areas, most notably London, where it prevailed until 1724. *See id.* at 114 n.104 (citing George W. Keeton & L.C.B. Gower, *Freedom of Testation in English Law*, 20 IOWA L. REV. 326, 338 (1935)).

83. *See id.* at 114-15 nn.104-06. Brashier cites J.H. BAKER, AN INTRODUCTION TO ENGLISH LEGAL HISTORY 293 (3d ed. 1990) and A.W.B. SIMPSON, A HISTORY OF THE LAND LAW 191 (2d ed. 1986) for the proposition that compulsory primogeniture was effectively eliminated with the Statute of Wills. *See id.* at 114 n.104. However, Brashier also notes that primogeniture was not officially abolished in England until 1925. *See id.* at 115 n.106.

84. *See id.* (citing MARYLYNN SALMON, WOMEN AND THE LAW OF PROPERTY IN EARLY AMERICA 149 (1986) (noting that in colonial Maryland, a testator's children had a forced share in their father's personal property)).

85. *Id.* at 115 n.106 (quoting THOMAS F. BERGIN & PAUL G. HASKELL, PREFACE TO ESTATES IN LAND AND FUTURE INTERESTS 9 (2d ed. 1984)).

86. 2 WILLIAM BLACKSTONE, COMMENTARIES *12, *cited in* DUKEMINIER & JOHANSON, *supra* note 75, at 1-2 (emphasis added).

87. *See* Ronald Chester, *Disinheritance and the American Child: An Alternative from British Columbia*, 1998 UTAH L. REV. 1, 2-4.

88. *See* Judith G. McMullen, *Family Support of the Disabled: A Legislative Proposal to Create Incentives to Support Disabled Family Members*, 23 U. MICH. J.L. REFORM 439, 442 (1990).

right to receive anything after his death.[89] The sole exception to this is the surviving spouse, who is protected from complete disinheritance.[90]

Another explanation for allowing disinheritance of children is that allowing testators to include or exclude children from shares in an estate may motivate the younger generation to be more attentive in caring for the needs of the older generation.[91] If offspring bear many of the financial and psychological costs of caring for their elders, that burden is less likely to be assumed by society.

Still another rationale is the presumed propensity of parents to act in the best interests of their children and other descendants. "[T]he parent more often than not will know better how to dispose of his property than will the state [which imposes] an inflexible blanket rule."[92] Perhaps a testator prefers to disinherit a child so that the child's incentive to achieve will not be dulled by an inherited nest egg. Sometimes parents of severely disabled children elect to disinherit them so as not to disturb eligibility for government aid programs which the disabled offspring might otherwise have. At other times, disinheriting children in favor of their surviving parent may indirectly benefit the children by preserving the parent's position of power and influence within the family. In these cases, the children may well be better off in the long run if they are disinherited, and their parents are in the ideal position to know this and to act upon it.

At any rate, parents' right to disinherit children is clearly established in all states but Louisiana. Of course, even if parents do not formally disinherit children in their wills, they can accomplish the same result by spending the entire estate during their own lifetimes. Longer life expectancies make it more likely that parents will spend their estates on ordinary living expenses, medical expenses, nursing home expenses or retirement luxuries such as travel or hobbies.[93] The most generous of will provisions cannot transfer money that is no longer in a parent's estate. Thus, some children inherit nothing without any affirmative act of disinheritance on their parents' part.

The above reasons may explain why American law allows the disinheritance of children. The next question is why an individual testator might choose to disinherit a child despite what Deborah A. Batts refers to as "the power of the

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89. *See id.* at 443 (citing Carol Dry Doup, Note, *Family Maintenance: An Inheritance Scheme for the Living*, 8 RUTGERS-CAM. L.J. 673, 674-75 (1977)).

90. *See generally* DUKEMINIER & JOHANSON, *supra* note 75, at 471-536.

91. *See* WILLIAM M. MCGOVERN, JR. ET AL., WILLS, TRUSTS AND ESTATES 88 (1988) (citing 2 BRACTON, DE LEGIBUS ET CONSUETUDINIBUS ANGLIAE 181 (Samuel E. Thorne trans., George E. Woodbine ed., 1968) (discussing King Lear, "who was mistreated by his daughters as soon as their share of his estate was secure")).

92. MCGOVERN ET AL., *supra* note 91, at 88 (quoting Max Nathan, Jr., *An Assault on the Citadel: A Rejection of Forced Heirship*, 52 TUL. L. REV. 5, 19 (1977)).

93. *See generally* Langbein, *supra* note 5 (stating that Americans have high expectations about quality of life in retirement and are apparently willing to spend what they have to achieve that quality. They appear disinclined to scrimp on their lifestyle to preserve an inheritance for their offspring, if indeed parents were ever inclined to do so.).

call of the blood."[94] There are several recognized reasons for a testator's decision to disinherit one or more of his children. As mentioned, the most problematic situation is where a testator may have diminished mental capacity,[95] or may be responding to fraud or undue influence.[96] If these situations occur (and can be proven) the will may be denied probate or another remedy could be provided by the court.

However, a testator could have one of several other reasons for disinheriting a child. The choice to spend resources rather than save them for the next generation, the preference towards giving property to a surviving spouse rather than descendants, the belief that the children have received enough from the parents already, the desire to keep children loyal and well-behaved, and the desire to make children independent are all recognized as reasons for the disinheritance of children. As will be discussed in Part III of this Article, similar reasons may lead parents to withhold payments for a child's higher education.

Sometimes, whether by design or by the chance of living a longer life with associated expenses, a testator may spend all his resources, leaving nothing to be inherited by a child. Greater life expectancies mean that people can expect to be alive for more retirement years. Expectations of a "good" retirement, including travel and leisure activities, make seniors more likely to spend their nest eggs than ever before. However, while this pattern of spending may result in nothing being left for the children to inherit, there may not be a deliberate disinheritance. In many cases, there will still be a will dividing property among the children, however there might not be any property to actually distribute when the time comes.

There are situations where a parent deliberately disinherits a child by stating in his will that the child is disinherited, or by simply leaving everything to someone else.[97] In many cases, a testator simply wants to leave the entire estate to the surviving spouse. This ensures that the surviving spouse will maintain the same standard of living as the couple had when both members were living, and satisfies notions that the property really belonged to both of them. "[T]he vast majority of couples, when surveyed, want the surviving spouse to inherit the

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94. Deborah A. Batts, *I Didn't Ask to Be Born: The American Law of Disinheritance and a Proposal for Change to a System of Protected Inheritance*, 41 HASTINGS L.J. 1197, 1264-65 (1990).

95. One example might be where an Alzheimer's patient no longer remembers one or more of his children. He would lack testamentary capacity, but if he executed a will without capacity, that would have to be proven in order to have the will denied probate.

96. If a third party tells the testator that his son is dead, but the son is not dead and the third party knows it, the will is fraudulently procured if the testator disinherits his son as a result. If instead of lying about the son's fate, the third party uses a variety of coercive and manipulative methods to get the testator to leave everything to him rather than to the son, then the disinheritance would be the result of undue influence.

97. However, to avoid claims of inadvertent disinheritance under pretermitted heir statutes, such a testator would be well advised to mention the children somewhere in the document.

entire estate."[98] Traditionally, the expectation has been that the remaining estate would pass to the children at the death of the surviving spouse. This prompted at least one scholar, Jeffrey P. Rosenfeld, to claim that leaving everything to the surviving spouse to guarantee a certain standard of living is not really disinheritance because "there is no intention of depriving (children) of their inheritance for any longer than the surviving spouse's lifetime."[99] However, this expectation may not be fulfilled in cases where the surviving spouse remarries. In those cases, the needs of the second surviving spouse may be of greater concern to the testator, who may follow the same pattern of leaving the whole estate to the surviving spouse. The children from the first marriage may never inherit at all, since a surviving stepparent may have a first family of her own.[100] Despite Rosenfeld's assertion, this really *is* disinheritance of the children from the first marriage.

In other cases, a testator may have made other provisions for surviving children, such as trusts, joint property or lifetime gifts, and may not wish for the children to inherit additional property from the estate.[101] For example, in their study of family distribution patterns, Sussman, Cates and Smith cite the example of a seventy-four-year-old widower who was disinheriting four children in favor of a fifth, who was caring for him. He stated that he had already given enough to the four children who were disinherited.[102] However, Sussman, Cates and Smith also cite the case of a sixty-seven-year-old widow who disinherited her two sons in favor of her three daughters. The will stated: "I have made no provision for Carl and Frederick, since I have given them a share of my estate

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98. Chester, *supra* note 87, at 4 n.16 (quoting CAROLE SHAMMAS ET AL., INHERITANCE IN AMERICA FROM COLONIAL TIMES TO THE PRESENT 211 (1987)).

99. *Id.* at 5 n.25 (quoting Jeffrey P. Rosenfeld, *Disinheritance and Will Contests*, *in* FAMILY SYSTEMS AND INHERITANCE PATTERNS 77 (Judith N. Cates & Marvin B. Sussman eds., 1982)).

100. *See* MARVIN B. SUSSMAN ET AL., THE FAMILY AND INHERITANCE 89-95 (1970) (discussing different examples of disinheritance of children from a first marriage in favor of a second spouse, and also discussing the interested parties' perceptions of the fairness of the results). In general, children from the first marriage did not begrudge the inheritance by the second spouse, especially if the second spouse had helped to build up the estate. However, they had a greater discomfort level if the estate had been partly built up through the efforts of their deceased parent, especially if the second spouse had children of his or her own, who might well inherit to their exclusion. *See id.* at 95.

101. Indeed, a parent may come to the conclusion that a child has already been adequately provided for because the parent has expended substantial resources, or even gone into debt, to pay the expenses of higher education for the child.

102. *See* SUSSMAN ET AL., *supra* note 100, at 101; *see also* Langbein, *supra* note 5, at 735 ("I've told my sons, your education is going to be your inheritance." (comment by Mr. Lu)). Of course, the implication of Mr. Lu's comment is that there will not be anything left to inherit. However, his comment could also be understood to mean that after his sizeable investment in his sons' education, he no longer feels compelled to leave them anything and may instead spend it or bequeath it to someone else.

during my lifetime."[103] The authors reported that the share referred to in the will was $1000 that each of the five children received when the widow sold her home. In later interviews, the five children had vastly different theories about why the brothers were disinherited. The daughters thought that it was because the sons had ignored their mother; the brothers denied this. One daughter believed that the mother had in fact depleted her bank account in favor of the boys. One of the sons theorized that his sisters had plied the mother with drinks, and she had plied the sisters with money. The entire estate was worth $5000.[104] If nothing else, this case illustrates that a parent's perception that the parent has already adequately provided for a disinherited child may not be shared by the child.

Related to the belief that the testator has already adequately provided for his child elsewhere is the perception that a child should be disinherited because he does not need the money, in contrast to other children, who may need it more. Sussman, Cates and Smith cite several instances of this rationale. In one case, a sixty-two-year-old widow planned to leave her estate to her daughter, with her daughter's children as contingent beneficiaries. She disinherited her son, with whom she was apparently on cordial terms, stating that her "son can take care of himself."[105] In another case, an eighty-five-year-old widow planned to disinherit the older of her two sons. She stated "that the disinherited son is doing quite well, but that the younger son has been involved in numerous unsuccessful business ventures and needs the money."[106] In a variation on this theme, a parent may disinherit a disabled child in order to preserve his eligibility for government benefit programs.[107]

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103. SUSSMAN ET AL., *supra* note 100, at 99.

104. *See id.*

105. *Id.* at 101.

106. *Id.*

107. *See generally* Lawrence A. Frolik, *Estate Planning for Parents of Mentally Disabled Children*, 40 U. PITT. L. REV. 305 (1979); McMullen, *supra* note 88; Carol Ann Mooney, *Discretionary Trusts: An Estate Plan to Supplement Public Assistance for Disabled Persons*, 25 ARIZ. L. REV. 939 (1983). As these articles point out, disinheritance is sometimes regarded by parents as the lesser of two evils. When disabled adult children have financial needs beyond what a parent could provide, the parent may allow the child to be emancipated, and the child will be eligible for public benefit programs. However, benefit programs have strict eligibility requirements. Any financial windfall, such as an inheritance, will make the child ineligible for benefits programs. Money from a support trust will have the same effect. In addition, any funds received by the disabled child may be immediately targeted for repayment of past expenses paid by the state.

> [P]ayments to the child will reduce or cause termination of disability payments, but unless the gift or inheritance is extremely large, it may not meaningfully or continuously improve the beneficiary's standard of living. Moreover, when the gift or inherited property is exhausted, there may be a delay in reinstating payment of the disability benefits. Faced with such ungratifying prospects, many people will conclude that a gift or bequest is not a good idea and will search for other options.

McMullen, *supra* note 88, at 450. As McMullen, Frolik and Mooney point out, disinheritance is one of those options. The articles go on to explore the possibility of a totally discretionary, or

Some testators disinherit children to punish them for neglecting their parents, or for other behavior that the parents deem unacceptable, such as marrying outside the family faith. Sometimes this is done by placing a condition on the inheritance—if the condition is met, the child receives the inheritance; if not, the child is disinherited. For example, a Jewish father might condition his son's inheritance on the son's marriage to a Jewish girl by a certain deadline. If the son is not so married, he loses his inheritance.[108] In other situations, testators may use a will to reward desirable behavior, such as caring for the testator in his declining years, while disinheriting children who have neglected their parents or failed to participate in the parents' care.[109] The impulse to use an inheritance to

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luxury trust.

The United States is not the only country where the expenses of supporting a disabled child may provide an incentive to disinherit that child. Foster cites the case of "a 'calculating' Chinese testator [who] deliberately impoverished his mentally and physically disabled daughter so that she would be supported at State expense." Foster, *supra* note 74, at 1220-21 (citing Case No. 41, *in* YI AN SHUO FA: JICHENG FA [USING CASES TO EXPLAIN LAW: INHERITANCE LAW] 75 (Li Qizhi et al. eds., 1986)). However, the United States is apparently more tolerant of the disinheritance solution. Foster reports that:

> The case commentary castigated the testator, Gao Da, for his offenses against both his daughter and society as a whole:
>
> "Gao Da did not leave the mandatory share of his estate to his daughter. He attempted to shift the burden of his daughter's livelihood to society. This type of 'calculation' infringes statutory provisions and is incorrect. Based on law and proceeding from reality, the court decided that Gao Da's will was invalid and redistributed the estate to promote the common interests of society and also to protect the legal rights and interests of Gao Da's daughter."

Id. at 1221 n.117 (quoting YI AN SHUO FA, *supra*, at 76).

108. *See* Shapira v. Union Nat'l Bank, 315 N.E.2d 825 (Ohio C.P. 1974) (holding that testator had a right to place restrictions on his bequests, and that the restrictions related to his son David's marital situation were neither unconstitutional nor a violation of public policy), *cited in* DUKEMINIER & JOHANSON, *supra* note 75, at 24.

109. *See, e.g.*, SUSSMAN ET AL., *supra* note 100, at 98-100 (describing seven instances of disinheritance). These seven instances shared

> at least one common factor: the decedent lived with one of his children. In several of the cases, the aged parent was sufficiently incapacitated to require constant attention. There seemed to be a consensus among the family members that a sibling who had given care to an aged parent should have received special consideration, even if the child had been living rent free.

Id. at 100. The authors go on to note, however, that some of the disinheritances were motivated by more than just who provided final care. In one case, for example, the disinherited daughter was a nun who had taken a vow of poverty. Her father had opposed her entering the convent. Despite the disinheritance of the nun, the sister who had taken care of the ailing father did not receive anything extra, but shared equally with her remaining siblings. *See id.* at 99-100. The disinheritance, then, was apparently not for the purpose of rewarding the caretaker child. Thus, this

reward behavior and disinheritance to punish wrongdoing may be the most universal of the possible motivations to disinherit a child.[110]

Finally, some parents are motivated to disinherit a child because the parents believe that inherited wealth keeps a child dependent and destroys his incentive to excel.[111] The billionaire Warren Buffet has stated that he intends to leave his fortune to charity rather than to his children because it would not be right for his children to inherit "a lifetime supply of food stamps just because they came out of the right womb."[112] Of course, it remains to be seen whether Mr. Buffett carries through with his planned disposition.

III. Argument Against Ordering Parents to Pay for College Expenses

Should family courts have the discretion to order divorced parents to pay their children's college and other post-majority educational expenses? As noted above,[113] only a few states give courts that power. Perhaps the most widely cited argument against imposing a payment requirement on divorced parents is simply that parents whose marriages remain intact are under no obligation to pay for college or any other post-majority expenses. Therefore, the argument is that obliging divorced parents to pay is a violation of those parents' right to equal protection.[114]

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latter example is perhaps more illustrative of the punishment function of disinheritance than it is of the reward function.

110. *See, e.g.*, Foster, *supra* note 74, at 1220 n.113 (citing Yu Lai v. Yu Jing & Chen Xia, *in* MIN SHANG FA SCHIWU YANJIU: JICHENG JUAN [A STUDY OF CIVIL AND COMMERCIAL LAW PRACTICE: INHERITANCE VOLUME 103 (Yang Zhenshan ed., 1993) (in which "a 'broken-hearted' mother . . . disinherited her adopted teenaged son [who was] a juvenile delinquent and truant since age seven")).

111. *See supra* text accompanying note 70.

112. Richard I. Kirkland, Jr., *Should You Leave It All to the Children?*, FORTUNE, Sept. 26, 1986, at 18 (quoting Warren Buffett and discussing the disinheritance of children by wealthy parents).

113. *See supra* text accompanying notes 23-46.

114. This argument has had some success in the courts. *See, e.g*, Curtis v. Kline, 666 A.2d 265 (Pa. 1995). *Kline* involved a challenge to a 1993 Pennsylvania law (23 PA. CONST. STAT. § 4327(a) (1993)) that gave courts discretion to order separated, divorced or unmarried parents to pay post-secondary educational expenses of their children. *See id.* at 253. The court concluded that the statute violated the equal protection clause of the Fourteenth Amendment to the U.S. Constitution. *See id.* at 258. The court stated:

> It will not do to argue that this classification is rationally related to the legitimate governmental purpose of obviating difficulties encountered by those in non-intact families who want parental financial assistance for post-secondary education, because such a statement of the governmental purpose assumes the validity of the classification. Recognizing that within the category of young adults in need of financial help to attend college there are some having a parent or parents unwilling to provide such help, the

If one approaches the question with the assumption that having one's education paid for by one's parents is a form of inheritance, other arguments emerge for not requiring divorced parents to pay the post-majority educational expenses of their children. The reasons that at least sometimes justify disinheritance of children at death can also be applied to justify refusal to pay for the children's college education during the parent's lifetime. Specifically, a divorced parent may choose not to pay college or other post-majority expenses for children of a former marriage because the parent prefers to spend the resources in other ways, because of the belief that the children have gotten enough support already, because the child's behavior is unacceptable to the parent, or because of a desire to have the child become independent.

Just as a testator may prefer to spend all of his money, or to leave all his property to a surviving spouse rather than to his children, a divorced parent may prefer to devote his current resources to a current spouse or minor children from a subsequent marriage. The case of *Blue v. Blue*[115] provides a fairly typical illustration of this phenomenon. The Blues separated in August 1987 when Mrs. Blue left the marital residence. Ten months later, Mr. Blue "decided that he needed to 'get on with his life' and purchased a $114,000 five-bedroom home. . . . The monthly mortgage payment for this new home was $1,187.00 a month or a monthly mortgage payment increase of $900.00."[116] Mr. Blue moved into the new home with his girlfriend and her two minor children. According to the case, Mr. Blue paid all monthly living expenses for the new members of his household, with the exception of medical expenses and his girlfriend's car payments.[117]

Prior to his parents' separation, the Blues' son Reginald had attended Penn State at his parents' expense. After the separation, and apparently because of his new household expenses and new loyalties, Reginald's father refused to continue paying college expenses. Forced to work and take out loans, Reginald sued his father for college support.[118] Although two lower courts found in Reginald's

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> question remains whether the authority of the state may be selectively applied to empower only those from non-intact families to compel such help. We hold that it may not. In the absence of an entitlement on the part of any individual to post-secondary education, or a generally applicable requirement that parents assist their adult children in obtaining such an education, we perceive no rational basis for the state government to provide only certain adult citizens with legal means to overcome the difficulties they encounter in pursuing that end.

Id. at 258-59 (footnotes omitted).

For a critical look at the *Kline* decision, see Charles F. Wilson, Note, *But Daddy, Why Can't I Go to College? The Frightening De-Kline of Support for Children's Post-Secondary Education*, 37 B.C. L. REV. 1099 (1996). *But see* Childers v. Childers, 575 P.2d 201 (Wash. 1978) (en banc), *excerpted in* HARRIS & TEITELBAUM, *supra* note 26, at 593-98.

115. 616 A.2d 628 (Pa. 1992).

116. *Id.* at 630.

117. *See id.*

118. However, as the court noted, "the son did not sue his mother under the same theory."

favor,[119] the Pennsylvania Supreme Court reversed, holding that the lower courts had abused their discretion in ordering the college payments. The supreme court dismissed Reginald's claim, noting that Pennsylvania law provided no right to have parents pay the expenses of higher education.[120]

The fact that Mr. Blue had spent lavishly on his new house and household members was apparently a deciding factor in the trial court's decision in favor of Reginald. "The trial court determined that the father caused his own undue hardship as the result of his real estate purchase."[121] However, except for a passing reference to the influence of this factor on the trial court's decision, the supreme court seemed to be totally unaffected by it. No judgment was uttered as to the reasonableness of the father's new spending pattern. The clear implication was that, in the absence of a contractual agreement binding the father to pay Reginald's college expense, the father's other spending decisions were simply irrelevant.

Payment of college expenses is by no means universal, even among parents whose marriages have remained intact. Aside from the expenses of second families, parents may choose not to support a child's college education because paying for post-majority expenses would jeopardize other financial goals, such as maintaining a comfortable lifestyle or saving for retirement. People need a good deal of money to retire comfortably, and middle-aged parents may prefer to assure their own financial security rather than spending heavily (or borrowing heavily) to pay for the college education of their children. "They're likely to be living a longer portion of their lives together as retirees than in the past, and their expectations for their post-work lives are higher than what previous generations set for themselves."[122] Factors such as the ages of the parents when the children are in college will influence the ability of the parents to contribute to tuition without jeopardizing their own financial future. Divorced parents share these same concerns with still-married parents and should be allowed to make the same considered judgments to address them.

As mentioned above, a testator might disinherit a child because of the belief that the parent has already provided adequately for the child, or because the parent believes that the child does not need the support.[123] Applied to the divorce

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Id. at 629 n.1.

119. The trial court ordered the father to pay $4600 per year towards Reginald's college education. However, the court ordered Reginald to apply for and accept loans and grants, the amount of which would reduce his father's obligation. *See id.* at 630. The superior court affirmed the requirement that the father pay $4600 per year, but reversed the trial court's requirement that Reginald seek loans and grants, reasoning that college expenses are the responsibility of parents. *See id.* (citing Blue v. Blue, 576 A.2d 1129 (Pa. Super. Ct. 1990)).

120. *See id.* at 632.

121. *Id.* at 631.

122. Laura Ramsay, *Navigating the Retirement Routine: For Some Couples the Lifestyle Change when One Retires Can Put a Strain on Their Marriage, Especially if Their Goals Are Not in Sync*, NAT'L POST, Oct. 11, 1999, at C13.

123. *See supra* text accompanying notes 101-07.

context, a non-custodial parent may feel that he has done more than enough by sacrificing to pay regular child support throughout the child's minority. In *Second Chances*, Judith Wallerstein and Sandra Blakeslee report that in their sample, this attitude was common among non-custodial fathers. "[T]hey tend to say, 'I paid my child support through the years. I met all my obligations. I've given my wife thousands of dollars, and now it's up to her.'"[124] Wallerstein and Blakeslee reported that this attitude prevailed even where the fathers could afford to help, valued education, and had cordial relations with their children.[125] Similarly, the parent might feel that the child has other resources to which he could turn for tuition payment, such as the loans and grants the father in *Blue* expected his child to use.

As previously discussed,[126] it is well known that at least some parents use disinheritance (or threats of it) to influence their children's actions, and to reward good behavior and punish bad behavior. Even in a non-estate planning setting, parents often use continued financial support as a reward or incentive as children grow older. However, if a divorced parent is legally obligated to pay for higher education, a child may cut off all contact, reject the parent's value system, and still collect the tuition money. This reduces a direct incentive for children to maintain a cordial relationship with non-custodial parents, and places those parents at an unfair disadvantage. A *Dear Abby* letter to newspaper advice columnist Abigail Van Beuren illustrates this point:

> I found your response to the twins whose divorced father would not continue child support payments or pay for higher education to be factually accurate, but a bit narrow in its vision.
>
> My wife left her home state 10 years ago for a much better job. After a child custody battle that almost bankrupted her, she was forced to leave her [eight]-year-old son and [six]-year-old daughter with her ex-husband. Despite a court order, her son refused to fly up to see her after the first few visits and was rarely available when she flew there. Football, basketball, friends—all held more importance than his mother. Despite her never missing a holiday gift, I can count on one hand the number of phone calls or thank-yous she has received. Care to guess how many times they forgot her birthday?
>
> When it came time for him to choose a college, my wife offered to assist with tuition if he considered an Ivy League school or the school from which she and her former husband graduated. She was chastised for trying to "force" him to attend a college he did not wish to.

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124. JUDITH S. WALLERSTEIN & SANDRA BLAKESLEE, SECOND CHANCES: MEN, WOMEN, AND CHILDREN A DECADE AFTER DIVORCE 158-59 (1989).

125. *See id.* at 158.

126. *See supra* text accompanying notes 55-57.

> Perhaps the twins should examine how they treated their father while the child support was paid consistently every month. Sounds like Dad held up his end. . . .
>
> —Been There, Done That[127]

Presumably, the mother referred to in the letter withheld tuition contributions because the son would not consider a school she approved of and because the son apparently demonstrated no interest in having a good relationship with her. If the college support had been court-ordered, the mother would have had no opportunity to adjust her behavior in response to her son's attitude. Imposing the obligation to pay college tuition on a non-custodial parent may give too much power to the child and his custodial parent, with the non-custodial parent reduced to unwillingly writing checks to ungrateful offspring.

Although many still-married parents continue to offer cash or in-kind support, including tuition, until a child has completed college or other post-secondary education, these parental stipends are likely to be reserved for children who continue to behave in ways that are acceptable to the parents. It is not reasonable to deny to divorced parents this ability to use rewards to influence their children's behavior. This is particularly true where the divorce and the ensuing reduction in time spent with the children have already operated to deprive a non-custodial parent of many opportunities for influence.

Finally, a parent may decline to pay the costs of his child's higher education because of the parent's belief that the child should be independent. "At some point parents expect that the children will 'quit going to school and go to work,' or at least pay for their own additional training."[128] Once again, it seems that divorced parents should have this opportunity to influence their child's maturity, just as married parents do.

Ultimately, requiring parents to pay post-majority educational expenses is inconsistent with another trend in family law: the policy of allowing divorced persons to walk away from a marriage and make a completely fresh start. In addition, parents are not generally liable for the debts of their adult children, although sometimes exceptions are made where the children are disabled.

IV. Objections to the Argument

There are at least three arguments in favor of allowing courts the discretion to order the payment of college expenses by divorced parents. First, some research has indicated that children of divorce are at greater risk, emotionally and financially, than are children in intact families. If this is true, these children and their custodial parents are less likely to be in a position to afford college expenses, especially in an atmosphere of rapidly rising costs. However, these same children may have an even greater need for higher education, to counterbalance some of their disadvantaged circumstances. Second, custodial

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127. Abigail Van Buren, *Dear Abby: Mom's Faithful Support Is Met Indifferently*, CHI. TRIB., Feb. 27, 1999, at 33.

128. HARRIS & TEITELBAUM, *supra* note 26, at 598.

parents appear to continue to shoulder, arguably voluntarily, many of the expenses. It is argued that it is unfair to expect them to do this alone. Third, giving courts the discretion to order payment of post-majority expenses will likely increase the number of parents who contribute to the education of their children.

As to the first argument, there have been studies that seem to indicate that children of divorce are at higher risk for social and economic difficulties. "The preponderance of the evidence suggests that, following divorce, custodial parents—almost always mothers—suffer considerable decline in economic well-being."[129] In one well-known study of the consequences of divorce, Lenore Weitzman argued that inadequate child support placed divorced women and their children in precarious financial circumstances:

> [T]he data point to three conclusions. First, the amount of child support ordered is typically quite modest in terms of the father's ability to pay. Second, the amount of child support ordered is typically not enough to cover even half the cost of actually raising the children. Third, the major burden of child support is typically placed on the mother even though she normally has fewer resources and much less "ability to pay."[130]

Other studies have suggested that the disadvantages experienced by children of divorce are not only financial, but emotional as well. Wallerstein and Blakeslee reported that in the group they studied, one third of the children were doing significantly *worse* five years after the divorce, when factors such as depression, behavior and learning problems were considered.[131] One "meta-analysis confirmed that children in divorced families, on average, experience more problems and have a lower level of well-being than do children in continuously intact two parent families."[132]

The argument is thus made that provision of educational supports could help these disadvantaged children of divorce to improve their life chances. Better-

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129. Jay Teachman & Kathleen M. Paasch, *Financial Impact of Divorce on Children and Their Families*, *in* CTR. FOR THE FUTURE OF CHILDREN, THE DAVID & LUCILE PACKARD FOUNDATION, 4 THE FUTURE OF CHILDREN: CHILDREN AND DIVORCE 1, 63 (1994) [hereinafter CTR. FOR FUTURE OF CHILDREN].

130. LENORE J. WEITZMAN, THE DIVORCE REVOLUTION 278 (1985). Weitzman argues that this negative effect is greatly exacerbated by the low percentage of fathers who are in compliance with their child support. She reports that more than half of women who are due child support do not receive the court-ordered support. *See id.* at 262.

131. *See* WALLERSTEIN & BLAKESLEE, *supra* note 124, at xvii.

132. Paul R. Amato, *Life-Span Adjustment of Children to Their Parents' Divorce*, *in* CTR. FOR FUTURE OF CHILDREN, *supra* note 129, at 145 (citing Paul R. Amato & Bruce Keith, *Parental Divorce and the Well-Being of Children: A Meta Analysis*, PSYCHOL. BULL. 26, 26-46 (1991)). This article analyzed the results of ninety-two studies involving over 13,000 children. "These problems include lower academic achievement, more behavioral problems, poorer psychological adjustment, more negative self-concepts, more social difficulties, and more problematic relationships with both mothers and fathers." *Id.* at 145.

educated children are more likely to be self-supporting at a reasonable level and are less likely to be a burden on society. However, there are a number of problems with this argument. First, emotional, behavioral and financial problems are not limited to children whose parents have divorced. Nor do all children of divorce experience problems of the same degree, kind and duration. "[A]lthough children of divorce differ, on average, from children in continuously intact two-parent families, there is a great deal of overlap between the two groups."[133] Amato also notes that "the average differences between children from divorced and continuously intact families are small rather than large. This fact suggests that divorce is not as severe a stressor for children as are other things that can go wrong during childhood."[134] Thus, unless we are willing to order college support for all children experiencing behavioral, emotional or financial problems, our solution will be both over and under inclusive. Second, legitimate policy concerns about the unique vulnerabilities of children of divorce could be addressed by other means, such as giving judges greater discretion over the use of support paid during minority, or offering tax or other incentives for parents who do provide extra educational support for their children.

The second argument also raises a good point, since it does appear that custodial parents often continue to support their children through college,[135] and it seems unfair to require them to shoulder this burden alone. This argument is made more compelling by the fact that mothers continue to retain primary custody in most cases, and mothers on average have fewer financial resources than their ex-husbands.[136] But it is important to remember that custodial parents are not being forced to support their children once those children have reached the age of majority. Even if it is true that custodial parents continue to provide support throughout college, they are doing so voluntarily. Why should the other parent be forced to pay more because of the way the custodial parent chooses to spend her resources? Contributing to college expenses might be a generous thing for the ex-spouse to do, but this does not justify making it a legal requirement.

Finally, it makes sense that requiring payment of post-majority educational expenses will increase the actual number of people who contribute to those expenses on behalf of their children. Not only will some parents pay because they have been ordered to do so, but more parents will agree to pay without being forced if they know that they will likely have to contribute something should the case go to trial.[137]

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133. *Id.* at 146.

134. *Id.* Amato continues: "For example, a recent meta-analysis of studies dealing with childhood sexual abuse revealed average effect sizes three to four times larger than those based on studies of children of divorce." *Id.* (citing Kathleen A. Kendall-Tackett et al., *Impact of Sexual Abuse on Children: A Review and Synthesis of Recent Empirical Studies*, 113 PSYCHOL. BULL. 164, 164-80 (1993)).

135. *See* WEITZMAN, *supra* note 130, at 279.

136. *See id.*

137. *See generally* Robert H. Mnookin & Lewis Kornhauser, *Bargaining in the Shadow of the Law: The Case of Divorce*, 88 YALE L.J. 950 (1979).

Voluntary contributions by able parents seem less likely in this group, given discouraging statistics on compliance with minority child support orders.[138] Knowing a judge could impose payments will encourage some people to make the payments without litigation. On the other hand, some people simply are not in the financial position to shoulder college costs. Analysis of when it would be fair to require payment will burden the judicial system. Moreover, given discouraging statistics on compliance with minority child support, there is no guarantee that a court-imposed order will *in fact* result in more parents paying for post-majority education. An order to pay post-majority educational support can be ignored just as readily as an order to pay child support during a child's minority. "[G]ood parents will always help their children, with or without the court orders, and bad parents will always figure out a way to dodge their responsibilities."[139]

CONCLUSION

This Article has attempted to show that divorced parents should not be forced to pay for the post-majority education of the children of their failed marriages. Education has become a form of intergenerational wealth transfer, as suggested by John Langbein in his 1998 article. Because parents are free to disinherit their children for any reason, they should be similarly free to decline to pay for the college costs of their children. The possible reasons for disinheritance or for refusal to pay post-majority educational costs are similar to each other, and similar as between divorced and married parents. Therefore, the result should be the same: the state should force neither divorced parents nor married parents to pay college or other post-majority educational expenses.

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138. *See* WEITZMAN, *supra* note 130, at 278.

139. Wilson, *supra* note 114, at 1100 (citing Interview with "40-ish" in the ChatWeb) (March 21, 1996)). "40-ish" had apparently had a bitter divorce from a successful physician. She alleged that her ex-husband had hidden most of the assets prior to the divorce hearing, so that she got very little property and only limited term support. The ex-husband, while supporting a lavish lifestyle for himself and his live-in girlfriend, refused to help his daughter with college expenses. *See id.*

RETHINKING THE FEDERAL RESERVE SYSTEM: A MONETARIST PLAN FOR A MORE CONSTITUTIONAL SYSTEM OF CENTRAL BANKING

MICHAEL WADE STRONG*

INTRODUCTION

This Article examines the evolution of American monetary policy and bank regulation and proposes a monetarist plan for reformulating the constitutional relationship between Congress, the President, and the Federal Reserve System. Under the proposed plan, Congress would replace the Federal Reserve System as the regulator of monetary policy, and the President would assume responsibility for bank regulation. This Article concludes that while the Federal Reserve System has functioned successfully as an independent central bank, the implementation of a monetarist plan, which divides the responsibility of monetary policy and bank regulation between the Congress and the President, would more truly realize the separation of powers principles embodied in the Constitution.

Before discussing the specifics of the monetarist plan, this Article presents some necessary background. Part I of the Article provides a brief history of central banking in the United States and traces the development of the Federal Reserve System. Part II examines the tools that the modern Federal Reserve uses to implement monetary policy and bank regulation. Part III discusses the consistencies between the Monetarists' theory of minimal intervention and the Framers' conception of limited government. It also examines three reasons why it would be politically practical for Congress to be responsible for monetary policy. Part IV discusses the benefits of assigning the President control over bank regulation, including the several checks and balances within the federal executive branch that enable the President to control the banking industry. The conclusion summarizes the major themes of this Article.

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I. A Brief History of Central Banking in the United States and the Development of the Modern Federal Reserve

A. The First and Second Banks of the United States

Maybe the Framers of the Constitution never envisioned an American political system in which monetary policy and bank regulation would substantially influence the daily movements of complex financial instruments such as commodity futures, stock options, and index funds. To be sure, the Framers did not seriously ponder political issues regarding bank regulation and monetary policy until nearly a decade after the passage of the Articles of Confederation and almost three years after the ratification of the 1788 Constitution.[1] Nonetheless, when the Framers chartered the First Bank of the United States in 1791, it became apparent that monetary policy and bank regulation would assume an all-important role in the American political system.

Prior to chartering the First Bank of the United States, the Framers saw no need to examine bank regulation and monetary policy in any significant detail. This stance was understandable. During that time, America was merely a fledgling democracy with a small agrarian economy and minimal banking needs.[2] By the late 1700s, however, the nation's financial landscape began to change. Most notably, the number of state-chartered banks began to proliferate well beyond the Framers' expectations.[3] To address this growth, the Framers found it necessary to design a central federal bank that could regulate and stabilize the development of state-chartered banks. However, no provision in the 1788 Constitution specifically authorized the creation of a central bank. As a result, a debate arose among the Framers regarding whether the Constitution permitted the Framers to establish the bank.

As the debate developed, two opposing sides arose. On one side, Secretary of the State Thomas Jefferson, a staunch agrarian, argued against creating the bank, fearing that it would unduly empower industrial proponents to promote a commercial agenda.[4] Jefferson also believed that it would be unconstitutional to

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1. *See* COMM'N ON THE BICENTENNIAL OF THE U.S. CONSTITUTION, THE CONSTITUTION OF THE UNITED STATES 40 (15th ed. 1991). The Articles of Confederation were ratified during the Revolutionary War in 1781 and governed the Colonies until June 21, 1788, when New Hampshire became the ninth state to ratify the U.S. Constitution. *See id.* The traditional view is that the Framers drafted the Constitution to correct defects in the Articles of Confederation related to economic concerns such as trade and commerce. The creation of the First Bank of United States in 1791 was an outgrowth of the economic concerns which inspired the Framers to draft the 1788 Constitution. *See* Maureen B. Callahan, *Cultural Relativism and the Interpretation of Constitutional Texts*, 30 WILLAMETTE L. REV. 609, 619 n.56, 622 (1994).

2. For an excellent historical overview of the banking industry in America, see JONATHAN R. MACEY & GEOFFREY P. MILLER, BANKING LAW AND REGULATION 2-36 (1992).

3. *See id.* at 5.

4. *See* DAVID S. KIDWELL ET AL., FINANCIAL INSTITUTIONS, MARKETS, AND MONEY 59 (5th ed. 1993).

establish the bank because no express provisions in the 1788 Constitution authorized its creation.[5] In Jefferson's mind, the only arguable constitutional authority for creating the bank was the necessary and proper clause contained in Article I, Section 8 of the Constitution.[6] Jefferson feared, however, that relying on the necessary and proper clause to justify creating the bank would initiate a slippery slope toward unlimited congressional power.[7] James Madison shared this concern, maintaining that creating the bank would result in unwarranted federal intrusion.[8]

On the other side of the debate, Alexander Hamilton, who drafted the bill for the bank, insisted that the Constitution's silence regarding the bank did not necessarily mean that creating the bank would be unconstitutional. Rather, in Hamilton's view, because the Constitution granted Congress the express power to tax, borrow, and regulate interstate commerce, the federal government had the authority to establish the bank. In contrast to Jefferson, Hamilton interpreted the necessary and proper clause as authorizing Congress to create any law that was "needful, requisite, incidental, useful, or conducive to" the ends of government.[9] Because a central bank would assist the federal government in conducting its financial affairs, Hamilton saw no problem establishing the bank.[10] In the end, Hamilton's view prevailed, and, on February 17, 1791, Congress approved a twenty-year charter for the First Bank of the United States—America's first central bank.[11]

Despite its controversial beginnings, the First Bank of the United States was a successful endeavor. Primarily, the Bank performed what would today be considered rudimentary tasks, such as financing the national government and offering loans to the general public.[12] During the colonial period, however, the concentration of these functions in one central bank was unprecedented. More significantly, the nationalization of the banking industry presented a grave threat

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5. *See* Stephen J. Friedman & Connie M. Friesen, *A New Paradigm for Financial Regulation: Getting from Here to There*, 43 MD. L. REV. 413, 416-17 (1984).

6. Congress shall have the power, "[t]o make all Laws which shall be necessary and proper for carrying into Execution the foregoing Powers, and all other Powers vested by this Constitution in the Government of the United States, or in any Department or Officer thereof." U.S. CONST. art. I, § 8, cl. 18.

7. *See* EDWARD L. SYMONS & JAMES J. WHITE, BANKING LAW: TEACHING MATERIALS 14 (2d ed. 1984).

8. *See id.*

9. Edward Flaherty, *A Brief History of Banking in the United States*, *in* THE AMERICAN REVOLUTION: AN HTML PROJECT (Department of Humanities Computing, 1997), *available at* http://members.home.net/flaherty15/history.pdf (last visited Mar. 16, 2001).

10. *See id.*

11. *See* ACTS TO CHARTER THE BANK OF THE UNITED STATES FEBRUARY 25; MARCH 2, 1791, § 3 (approved Mar. 2, 1791), *reprinted in* 1 DOCUMENTARY HISTORY OF BANKING AND CURRENCY IN THE UNITED STATES 307 (Herman E. Krooss ed., 1969).

12. *See* C. James Judson & Susan G. Duffy, *State and Local Taxation of Financial Institutions: An Opportunity for Reform*, 39 VAND. L. REV. 1057, 1060 (1986).

to state-chartered banks which, in relative terms, lacked the legal and financial resources to compete with a federal institution. This threat arose primarily because state-chartered banks focused exclusively on local affairs, whereas the First Bank of the United States, with its superior resources, operated across state lines.[13] The First Bank of the United States also enjoyed a limited degree of branching capability.[14] Eventually, the economic impact of the Bank even astounded its creators, who never expected it to have a significant impact on national affairs. Yet to state-chartered banks, who feared its influence, the First Bank of the United States was a behemoth that had to be slain. Soon, the state banks' concerns gained the ear of Congress, which responded by rekindling the original constitutional debate regarding the Bank's creation.[15] Ultimately, Congress acquiesced to the state-chartered banks and voted against rechartering the Bank.[16] As a result, the First Bank of the United States disappeared from existence when its twenty-year charter expired in 1811.[17]

The demise of the First Bank of the United States did not squelch the movement towards central banking. To the contrary, the Bank's success made it clear to both its proponents and critics that a central bank could not only stabilize the banking industry, but could also enhance the government's ability to serve the public. This fact became even more apparent just one year later when, due to the Bank's absence, America struggled to finance the War of 1812.[18] After the war ended, America's financial health further deteriorated as the nation grappled with price inflation resulting from the war.[19] Faced with a financial and political crisis, the American people urged its leaders to create a new institution—one that could fill the void left by the First Bank of the United States. Answering the call, Congress drafted legislation for a second central bank, and on April 10, 1816, the Second Bank of the United States came into existence.[20]

Like its predecessor, the Second Bank of the United States was chartered for a finite period of twenty years.[21] During its early years, however, the Bank was

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13. *See* Stacey Stritzel, *The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994: Progress Toward a New Era in Financial Services Regulation*, 46 SYRACUSE L. REV. 161, 165 (1995).

14. *See id.*

15. *See* Flaherty, *supra* note 9.

16. *See* MACEY & MILLER, *supra* note 2, at 6-8. A secondary argument that Congress advanced against the First Bank of the United States focused on the Bank's encroachment into the area of state sovereignty preserved by the Tenth Amendment. *See id.* Although Congress did not recharter the Bank, it is worthwhile to note that the vote on rechartering the Bank was lost by only one vote in both the House and Senate. *See id.*; BRAY HAMMOND, BANKS AND POLITICS IN AMERICA FROM THE REVOLUTION TO THE CIVIL WAR 222 (1957).

17. *See* MACEY & MILLER, *supra* note 2, at 6.

18. *See* Judson & Duffy, *supra* note 12, at 1060.

19. *See* Flaherty, *supra* note 9.

20. *See id.*

21. *See id.*

grossly mismanaged and did little to cure the nation's woes.[22] Trumpeting this impotence, a group of the Bank's staunchest opponents mounted two new legal challenges against the Bank.[23] In 1819, the Supreme Court repelled the first of these challenges when, in *McCulloch v. Maryland*, the Court voted 9-0 to uphold the constitutionality of the Bank.[24] Writing for the Court in *McCulloch*, Chief Justice Marshall found that both the necessary and proper clause and Congress' power to declare war and raise revenue provided constitutional bases for establishing the Bank.[25] Five years later, in 1824, the Supreme Court repelled a second constitutional challenge against the Bank when, in *Osborn v. Bank of the United States*, the Court once again concluded that the Bank was "an instrument which is 'necessary and proper' for carrying on the fiscal operations of government."[26] The *Osborn* court reaffirmed *McCulloch* in reaching this conclusion.[27]

McCulloch and *Osborn* breathed new life into the Second Bank of the United States, providing the time it desperately needed to solve its managerial problems. This new life, however, was not enough to save the Bank. Merely four years after the *Osborn* decision, the death-knell rung when Andrew Jackson, one of the Bank's fiercest critics, became President of the United States. Once inaugurated, Jackson wasted no time in ensuring the Bank's demise. In 1832, Jackson's efforts to destroy the Bank took full effect when he vetoed a bill to recharter the Bank.[28] Though anticipated, Jackson's action came much earlier than expected, as the twenty-year charter for the Bank was not due to expire until 1836.[29] In the wake of Jackson's veto, Congress presented no other bills to recharter the Bank. Consequently, the Second Bank of the United States ceased operations in 1836.[30] For the next seventy-seven years, America conducted its financial affairs without the benefit of a central bank. Then, on December 23, 1913, that trend changed forever when President Woodrow Wilson signed the Federal Reserve Act into law—the scion of the Second Bank of the United States.[31]

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22. *See* JOHN KENNETH GALBRAITH, MONEY: WHENCE IT CAME, WHERE IT WENT 76-78 (2d ed. 1995).

23. *See* Osborn v. Bank of the United States, 22 U.S. 738 (1824); McCulloch v. Maryland, 17 U.S. 316 (1819).

24. *See McCulloch*, 17 U.S. at 436.

25. *See id.* at 324.

26. *Osborn*, 22 U.S. at 861.

27. *See id.*

28. *See* Flaherty, *supra* note 9.

29. *See id.*

30. *See id.*

31. *See* BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, THE STRUCTURE OF THE FEDERAL RESERVE SYSTEM: THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM (1994), *at* http://www.Federalreserve.gov/pubs/frseries/frseri.htm [hereinafter THE STRUCTURE OF THE FEDERAL RESERVE SYSTEM] (last visited Mar. 16, 2001).

B. The Modern Federal Reserve

Like the legislation that created the Second Bank of the United States, the Federal Reserve Act of 1913 was intended to restore stability to the American banking industry, which had been in a state of disarray since the Banking Panic of 1907.[32] The Federal Reserve Act, however, was more ambitious than either of the charters for the First or Second Bank of the United States.[33] Indeed, its drafters intended this effect by assigning four expansive responsibilities to the new central bank. First, the Bank was "to serve as the lender of last resort during times of [financial] crisis,"[34] similar to the role that the First Bank of the United States potentially would have served during the War of 1812. Second, the Bank was to provide a flexible national currency that would be responsive to changes in supply and demand—a trait that neither of its predecessors possessed.[35] Third, the Bank was assigned the supervisory responsibility over the banking industry, which historically had been disjunctive and fragmented throughout the states.[36] Finally, the Bank was intended to improve the nation's check-clearing system, which likewise had been a poster-child for unpredictability and delay.[37]

To achieve these lofty goals, the Federal Reserve Act established a system of twelve Federal Reserve Banks located in major cities throughout the nation.[38] The Act also established a seven member Federal Reserve Board,[39] headquartered in Washington D.C. In addition to supervising the twelve Federal Reserve Banks, the Board maintained general control over the Federal Reserve System.[40]

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32. *See* THIBAUT DE SAINT PHALLE, THE FEDERAL RESERVE: AN INTENTIONAL MYSTERY 48-49, 54 (1985). The Banking Panic of 1907 was the worst of four national banking crises occurring since 1873. *See* Federal Reserve Bank of Minneapolis, *Born of a Panic: Forming the Federal Reserve System*, THE REGION, Aug. 1988, *at* http://woodrow.mpls.frb.fed.us/pubs/region/reg888a.html (last visited Mar. 16, 2001) [hereinafter *Born of a Panic*]. The Panic arose primarily because the existing banks chose to operate independently, rather than as a collective unit, when cash ran short. *See id.* Had the banks lent funds to one another, instead of hoarding cash, the Panic may not have occurred.

33. *See id.*

34. *Id.*

35. *See id.*

36. *See id.*

37. *See id.* The preamble to the Federal Reserve Act memorializes these aims, stating that the Act was intended "to provide for the establishment of Federal reserve banks, to furnish an elastic currency, to afford a means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes." Federal Reserve Act, 38 Stat. 351 (1913) (codified as amended in scattered sections of 12 U.S.C.).

38. Currently, the twelve regional Federal Reserve Banks are located in Atlanta, Boston, Chicago, Cleveland, Dallas, Kansas City, Minneapolis, New York, Philadelphia, Richmond, St. Louis, and San Francisco. *See* DE SAINT PHALLE, *supra* note 32, at 4.

39. *See Born of a Panic*, *supra* note 32. This governing body is now known as the "Board of Governors" of the Federal Reserve System. *See id.*

40. *See* THE STRUCTURE OF THE FEDERAL RESERVE SYSTEM, *supra* note 31.

All nationally chartered banks were required to become members of the Federal Reserve System.[41] State-chartered banks, by contrast, were accorded the option to join.[42] Additionally, "nonmember banks" were not governed by the Federal Reserve Act.[43] Any nonmember bank, however, could avail itself the Federal Reserve's check clearing system, so long as it maintained an appropriate balance with the twelve Federal Reserve Banks.[44]

Unlike most government entities, the Federal Reserve System was not established under the direct control of any branch of the federal government.[45] Nor was the system funded by government appropriations.[46] Instead, each Federal Reserve Bank, or District Bank, was established as a banking corporation and acquired funds from interest earned on government securities and income provided by the banking industry.[47] Each District Bank, like any private corporation, also maintained the power to appoint its own board of directors, officers, and employees.[48] The board of directors, comprised of two local bankers, headed each District Bank.[49] However, by the late 1920s, nine members made up of the board—three of whom were selected from the member banks, another three of whom were selected from the banking industry, and a final three of whom were appointed by the Federal Reserve Board.[50] The board of directors for each District Bank maintained the power to elect one representative to the Federal Advisory Board,[51] which periodically met in Washington D.C.[52]

Analogous to a corporation and its stockholders, the twelve District Banks provided financial services to their member banks.[53] Such services now include holding monetary reserves for the member banks, discounting certain financial notes, drafts, and bills of exchange, and offering monetary advances on certain promissory notes.[54] No agency relationship exists, however, between the Federal

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41. *See id.*

42. *See Born of a Panic*, *supra* note 32.

43. *See* Brookings State Bank v. Fed. Reserve Bank of S.F., 281 F. 222, 225 (D. Or. 1922).

44. *See id.*

45. *See* THE STRUCTURE OF THE FEDERAL RESERVE SYSTEM, *supra* note 31.

46. *See id.*

47. *See id.*

48. *See* DE SAINT PHALLE, *supra* note 32, at 4-5.

49. *See id.*

50. *See* Raichle v. Fed. Reserve Bank of N.Y., 34 F.2d 910, 912 (2d Cir. 1929).

51. Under the Federal Reserve Act, the Federal Advisory Board is empowered to confer directly with the Federal Reserve Board on issues regarding the general condition of business. It is also empowered to call for information and make recommendations regarding discount rates and the general affairs of the Federal Reserve System. *See* Federal Reserve Act of 1913 c. 6. § 12A, 12 U.S.C. § 263(a) (2000).

52. *See id.* § 12, 12 U.S.C. § 261 (1999).

53. *See* THE STRUCTURE OF THE FEDERAL RESERVE SYSTEM, *supra* note 31. Under the Federal Reserve Act, each member bank is a stockholder of the twelve Federal Reserve Banks.

54. *See Raichle,* 34 F.2d at 913.

Reserve Banks and the member banks.[55] Rather, both groups are separate and distinct corporate entities, and neither group has the authority to act on behalf of the other.[56] The District Banks derive their authority solely from the Federal Reserve Act.[57] The Banks have no powers greater than those granted by the Act and certain incidental powers necessary to carry on the business of banking.[58]

In its current form, the Federal Reserve System, through its seven member Board of Governors, functions as the sole implementor of the monetary policy.[59] At its inception, however, the Board of Governors devoted little or no attention to establishing monetary policy.[60] Indeed, during their early years, neither the Board of Governors nor the Federal Reserve District Banks even considered asserting control over the money supply. Instead, both the Board and the Federal Reserve Banks concentrated on performing the basic functions specified in the Federal Reserve Act.[61] Ignorance, to a great extent, spawned this indifference. And, because no express provisions in the Federal Reserve Act authorized the Board of Governors or the District Banks to assert control over monetary policy, the issue never produced any serious debate. In the early 1920s, however, the Board of Governors shed its ambivalence as a result of the incredible foresight of Benjamin Strong—the extraordinary Governor of the New York Federal Reserve Bank.[62]

Governor Strong was the first influential banker to realize that the Federal Reserve System possessed the means to establish monetary policy.[63] To the chagrin of many prominent bankers, Strong understood that by adjusting reserve requirements and buying or selling government securities, the Federal Reserve could actively control the money supply.[64] Initially, Strong implemented his policies exclusively through the New York Federal Reserve Bank.[65] In 1922, however, Strong expanded his operations. That year, both he and other powerful leaders, such as Treasury Secretary Andrew Mellon, joined forces to create a special government commission on monetary policy.[66] Ultimately, Strong's New York activities garnered the attention of the Board of Governors in Washington, D.C., which had accorded little notice to his work. But once aware of Strong's initiative, the Board replaced the special government commission with its own regulatory committee. The new committee, known as the Open Market Investment Committee of the Federal Reserve System, took over most of Strong's

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55. *See* Fed. Reserve Bank of Richmond v. Lakin, 81 F.2d 1003, 1005 (4th Cir. 1936).

56. *See id.*

57. *See* Armano v. Fed. Reserve Bank of Boston, 468 F. Supp. 674, 675-76 (D. Mass 1979).

58. *See id.* at 676.

59. *See* DE SAINT PHALLE, *supra* note 32, at 3.

60. *See id.* at 57.

61. *See id.*

62. *See* MACEY & MILLER, *supra* note 2, at 16.

63. *See* DE SAINT PHALLE, *supra* note 32, at 61.

64. *See id.*

65. *See id.*

66. *See id.* at 62.

operations and formally placed them under the direct supervision of the Board in Washington, D.C.[67] Later, due to Strong's efforts, the Open Market Investment Committee became the evolutionary predecessor to the current Federal Open Market Committee[68]—the most important policy-making body in the Federal Reserve System.

As the Open Market Investment Committee gained importance, the Federal Reserve System entered its adolescent stage. However, it was not until the 1930s that the Federal Reserve System matured completely and assumed its modern form. At that time, Marriner C. Eccles, another extraordinary banker, took the mantle from Strong and spearheaded a new initiative for restructuring the Bank. Foremost, during a 1934 appearance before the Senate Finance Committee, Eccles recommended that the Federal Reserve System be reformed through the codification of the many informal policies for controlling the money supply.[69] Under this proposal, decisions regarding monetary policy would emanate directly from the Board of Governors in Washington, D.C., rather than from the twelve District Banks.[70] To achieve this end, Eccles assigned the Board of Governors the authority to oversee the internal operations of the District Banks. The Board could also override the Banks' policy decisions whenever they conflicted with those of the Board.[71]

Eccles' changes had the practical effect of reducing the status of the twelve District Banks, making each bank subservient to decisions of the Board.[72] Control over the Federal Open Market Committee was also assigned to the Board.[73] Finally, Eccles isolated the Board from political influence by removing the Secretary of the Treasury and Comptroller of the Currency from the Board, both of whom represented the President of the United States.[74] With this change, the Board became insulated from public accountability,[75] as no member of the Board was under the direct control of an elected official. In essence, the Board could formulate any policies it wished, and the President would not be politically accountable.[76] On August 23, 1935, Eccles' plan was formally codified in Title II of the Glass-Steagall Act.[77] At that point, the modern Federal Reserve System

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67. *See id.*

68. In its present form, the Federal Open Market Committee consists of the President of the New York Federal Reserve Bank, the seven members of the Board of Governors in Washington, D.C., and four of the presidents of the eleven other district banks. *See* 12 U.S.C. § 261 (2000).

69. *See* DE SAINT PHALLE, *supra* note 32, at 74.

70. *See* WILLIAM GREIDER, SECRETS OF THE TEMPLE: HOW THE FEDERAL RESERVE RUNS THE COUNTRY 312 (1987).

71. *See id.*

72. *See id.* at 312-13.

73. *See id.* at 313. Seven of the twelve votes were from the governors. The remaining votes rotated among the Reserve Bank Presidents. *See id.*

74. *See id.*

75. *See id.*

76. *See id.*

77. *See* Banking Act of 1935, c. 614, § 1, 49 Stat. 685 (codified as amended in scattered

came into existence. In all basic respects, it has remained unchanged since that time.

II. THE POLICY-MAKING TOOLS OF THE MODERN FEDERAL RESERVE

As previously discussed, the Federal Reserve Act of 1913 contained no provisions which authorized either the Federal Reserve Board or the twelve Federal Reserve Banks to establish monetary policy.[78] To the contrary, the Act created the Federal Reserve System for the general purpose of reducing the risk of failures in the banking industry. However, as the System matured, both the Federal Reserve Board and the twelve Federal Reserve Banks acquired control over monetary policy through human innovation.[79] Be that as it may, nothing in the original Federal Reserve Act provided the Federal Reserve System with the formidable array of policy-making tools it now possesses to regulate banks and the money supply.

The modern Federal Reserve has many tools at its disposal to assist it in regulating banks and the money supply. For the purposes of policy-making, however, it has only four significant tools:[80] (1) open market operations, (2) the discount rate, (3) reserve requirements, and (4) authority over member banks and bank holding companies.[81]

A. Open Market Operations

Open market operations are the most important policy-making tool of the modern Federal Reserve System.[82] As the name suggests, these operations involve the buying and selling of government securities, such as Treasury bonds and bills,[83] on the "open market." This open market consists of numerous parties, including individuals, banks, and corporations.[84]

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sections of 12 U.S.C.).

78. In this Article, the term "monetary policy" refers to the Federal Reserve's decisions regarding the amount of money it desires to circulate in the economy. *See* Shahriar Tavakol, Comment, *Digital Value Units, Electronic Commerce and International Trade: An Obituary for State Sovereignty over National Markets*, 17 J. MARSHALL J. COMPUTER & INFO. L. 1197, 1206-07 n.94 (1999) (citing N. GREGORY MANKIW, MACROECONOMICS 144 (2d ed. 1994)).

79. *See* MILTON FRIEDMAN, A PROGRAM FOR MONETARY STABILITY 25 (1960). Friedman argues that Federal Reserve's "haphazard assortment of tools reflects mainly historical accident." *Id.* He further asserts that since control over monetary policy did not develop from a prior commitment to history, any proposed reforms for streamlining the Federal Reserve may be implemented without concern about disrupting the operations of the existing system. *See id.*

80. *See id.*

81. See *infra* Part II.D for definitions of member banks and bank holding companies.

82. *See* Fed. Open Mkt. Comm. of the Fed. Reserve Sys. v. Merrill, 443 U.S. 340, 343 (1979).

83. *See* MAXWELL NEWTON, THE FED: INSIDE THE FEDERAL RESERVE, THE SECRET POWER CENTER THAT CONTROLS THE AMERICAN ECONOMY 64 (1983).

84. *See generally* BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, THE FEDERAL

When the Federal Reserve buys government securities on the open market, it purchases them with a Federal Reserve check.[85] When the Federal Reserve issues this check, payment for the securities is ordinarily credited in the reserve account of the seller's bank.[86] Receipt of this payment augments the amount of reserves in the seller's bank with no offsetting decline in reserves elsewhere, thereby increasing the supply of money that is available for lending.[87] When the Federal Reserve sells government securities on the open market, the opposite occurs. In that situation, the securities' purchaser pays the Federal Reserve with a check on his or her bank.[88] When the check clears, the sale price of the securities is debited in the reserve account of the purchaser's bank.[89] Debiting this payment reduces the amount of reserves in the purchaser's bank with no offsetting decline in reserves elsewhere, thereby decreasing the supply of money that is available for lending.[90]

By statute, the Federal Open Market Committee (FOMC) has exclusive authority to conduct open market operations.[91] Because it is the sole governing body with this power, the FOMC possesses complete policy-making control over the money supply. Ordinarily, the amount of reserves available for lending dictates the FOMC's approach toward setting the money supply. For example, if the circumstances indicate that the amount of reserves will require constant adjustment, then the FOMC will directly purchase and sell securities on the open market.[92] In turn, if the amount of reserves requires only a temporary adjustment, then the FOMC may enter into repurchase agreements (when temporary additions are needed) or engage in matched sale-purchase transactions (when temporary reductions are required).[93] In most cases, the amounts of reserves will require only a temporary adjustment.[94] Consequently, when the FOMC implements monetary policy, it typically does so by entering repurchase agreements and engaging match-sale purchase transactions rather than dealing in direct purchases and sales of securities on the open market.[95]

Through open market operations, the Federal Reserve attempts to sustain economic growth and stabilize the money supply.[96] In theory, if the Federal

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RESERVE SYSTEM: PURPOSES & FUNCTIONS 35-41 (8th ed. 1994) [hereinafter THE FEDERAL RESERVE SYSTEM: PURPOSES & FUNCTIONS].

85. *See* NEWTON, *supra* note 83, at 65.

86. *See id.*

87. *See id.*

88. *See id.*

89. *See* Fed. Open Mkt. Comm. of the Fed. Reserve Sys. v. Merrill, 443 U.S. 340, 343 (1979).

90. *See* NEWTON, *supra* note 83, at 65.

91. *See* 12 U.S.C. § 263(b) (2000).

92. *See* THE FEDERAL RESERVE SYSTEM: PURPOSES & FUNCTIONS, *supra* note 84, at 38-39.

93. *See id.*

94. *See id.*

95. *See id.*

96. *See id.*

Reserve were able to accurately predict the movements of the "money multiplier" (i.e., the ratio of the amount of money circulating in the economy to the amount of money on deposit at the Federal Reserve), then the FOMC could use open market operations to control the money supply exactly.[97] In reality, though, the money multiplier is extremely unpredictable.[98] As a result, open market operations cannot be utilized to set the supply of money at any predetermined level for any significant period of time.[99] Despite this shortcoming, the dollar-for-dollar impact of open market operations on bank reserves makes those activities the Federal Reserve's most powerful, flexible, and precise policy-making tool.[100]

B. The Discount Rate

The discount rate is the Federal Reserve's second most powerful policy-making tool. Simply defined, the discount rate is the interest rate that member banks are charged when they borrow funds from the Federal Reserve.[101] Originally, the discount rate was set independently by each Federal Reserve District Bank, depending on the banking and credit conditions in the subject district.[102] Over time, however, the nationalization of the banking industry diminished the practicality of setting the rate on a regional basis.[103] "As a result, the Federal Reserve maintains a uniform structure of discount rates across all Reserve Banks."[104]

All banks must maintain a set level of reserves with the Federal Reserve System.[105] When banks do not have enough funds to meet the prevailing required level of reserves, they must borrow money from the Federal Reserve at the discount rate.[106] Typically, banks will hold more reserves during periods of high discount rates because a high discount rate means that the cost of borrowing money is also high.[107] Holding more reserves means banks have less money available for lending.[108] Hence, by setting a high discount rate, the Federal Reserve can increase the amount of reserves held by banks, and thereby reduce

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97. *See* RUDIGER DORNBUSCH & STANLEY FISCHER, MACROECONOMICS 375-76 (Paul V. Short ed., 4th ed. 1987).

98. *See id.* at 375.

99. *See id.* at 375-76 (citing James M. Johannes & Robert H. Rasche, *Predicting the Money Multiplier*, 5 J. MONETARY ECON. 301 (1979)).

100. *See* THE FEDERAL RESERVE SYSTEM: PURPOSES & FUNCTIONS, *supra* note 84, at 36.

101. *See* DE SAINT PHALLE, *supra* note 32, at 91.

102. *See* THE FEDERAL RESERVE SYSTEM: PURPOSES & FUNCTIONS, *supra* note 84, at 44.

103. *See id.*

104. *Id.*

105. *See id.* at 46.

106. *See* NEWTON, *supra* note 83, at 65.

107. *See generally* DORNBUSCH & FISCHER, *supra* note 97, at 390.

108. *See id.*

the money supply.[109] Conversely, when the discount rate is low, banks will hold less reserves.[110] Maintaining less reserves increases the amount of money available for lending.[111] Thus, by setting a low discount rate, the Federal Reserve decreases the amount of reserves held by banks and increases the money supply.[112]

Historically, the discount rate has not been a reliable policy-making tool. This unreliability stems from the extreme sensitivity of the discount rate to changes in the velocity of money.[113] Due to this sensitivity, the Federal Reserve has been unable to consistently predict the proportional effect of an incremental increase in the discount rate on the money supply. The most likely reason for this unpredictability is that individual banks, not the Federal Reserve, decide the quantum by which they wish to increase (or decrease) the amount of reserves they hold when the Federal Reserve decides to raise (or lower) the discount rate. Perhaps if the Federal Reserve could directly control the reserve decisions of individual banks, the discount rate would be a more powerful policy-making tool.[114]

C. Reserve Requirements

Reserve requirements are the Federal Reserve's third most important policy-making tool. To satisfy reserve requirements, banks must keep a percentage of their deposits on reserve with the Federal Reserve System in specified assets.[115] Prior to 1980, only the member banks of the Federal Reserve were required to satisfy reserve requirements.[116] Today, however, all depository institutions, regardless of their membership status, are subject to the reserve requirements established by the Federal Reserve.[117]

When the Federal Reserve increases reserve requirements, banks must keep a larger sum of deposits on account and, therefore, have less money available for lending. Thus, an increase in reserve requirements results in a decrease in the money supply. In turn, when the Federal Reserve decreases reserve

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109. *See id.*

110. *See id.*

111. *See id.*

112. *See id.*

113. "The . . . *velocity of money* is the number of times the stock of money is turned over per year in financing the annual flow of income." *Id.* at 359. In mathematical terms, the velocity of money is the "ratio of nominal income to nominal money stock." *Id.* at 360.

114. The Federal Reserve adjusts the discount rate when the market reflects a change in the velocity of money. Since the Federal Reserve usually changes its policy in reaction to a change in the velocity of money, the discount rate is said to be a lagging indicator. Because lagging indicators record instead of predict changes in the economy, they are not effective policy-making tools. *See* DE SAINT PHALLE, *supra* note 32, at 92.

115. *See* THE FEDERAL RESERVE SYSTEM: PURPOSES & FUNCTIONS, *supra* note 84, at 53.

116. *See id.*

117. *See id.* at 53-54.

requirements, banks can keep a smaller sum of money available for lending. Hence, a decrease in reserve requirements results in an increase the money supply. By ordering only a small increase (or decrease) in reserve requirements, the Federal Reserve can remove (or inject) an enormous amount of funds into the money supply.[118]

Because the precise quantitative effect of a change in reserve requirements is nearly impossible to predict, the Federal Reserve rarely uses reserve requirements as a policy-making tool.[119] Furthermore, like the discount rate, reserve requirements have not functioned effectively as a policy-making tool. From the Federal Reserve's perspective, a good policy-making tool is one that produces fine, graduated changes in the money supply. Changes in the reserve requirements typically do not have this effect. Rather, such changes more often result in crude, haphazard changes in the money stock. Thus, ordinarily, the Federal Reserve will implement monetary policy by changing reserve requirements only as a measure of last resort.

D. Member Banks and Bank Holding Companies

The power to regulate member banks and bank holding companies represents the Federal Reserve's fourth most important policy-making tool. In simple terms, a member bank is any financial institution that maintains ownership of stock in the Federal Reserve.[120] A bank holding company is any firm that maintains authority over a bank or any other firm that controls a bank.[121]

As noted earlier, all national banks are required to become member banks of the Federal Reserve System.[122] State-chartered banks, however, are not required to join.[123] Through strict regulation, the Federal Reserve can dictate the day-to-day decisions of its member banks, including their policies and procedures. For this reason, the number of member banks in the Federal Reserve System has steadily declined over the last fifty years.[124] Despite this trend, the Federal Reserve continues to strictly regulate its member banks, which significantly impedes its ability to implement effective monetary policy.

Whereas member banks have always been regulated by the Federal Reserve, bank holding companies have only been regulated by the Federal Reserve since 1956. That year, Congress passed the Bank Holding Company Act as a response to the rapidly growing use of bank holding companies as mechanisms for maneuvering around legal limitations on depository institutions.[125] Earlier, Congress attempted to stop the maneuvering by passing the Glass-Steagall Act,

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118. *See* DE SAINT PHALLE, *supra* note 32, at 92.

119. *See id.*

120. *See id.* at 6.

121. *See* MACEY & MILLER, *supra* note 2, at 296.

122. *See* THE STRUCTURE OF THE FEDERAL RESERVE SYSTEM, *supra* note 31.

123. *See id.*

124. *See* DE SAINT PHALLE, *supra* note 32, at 6.

125. *See id.* at 7-8.

which somewhat randomly assigned the responsibility of holding company regulation to the Federal Reserve. However, because the Glass-Steagall Act only accorded the Federal Reserve minimal authority to regulate holding companies, Congress passed the 1956 Act with the intent to expand and formalize the Federal Reserve's regulatory power. In short, the Federal Reserve acquired its regulatory power over bank holding companies because Congress viewed it as the organization most capable of assuming that responsibility.

III. A MONETARIST PLAN FOR CONGRESSIONAL CONTROL OF THE MONEY SUPPLY

A. Monetarist Theory and The Framers' Constitution

Although meticulous and astute, the Framers included no clauses or provisions in the 1788 Constitution that explicitly addressed the issue of monetary policy. Even today, despite the fact that the Federal Reserve has acquired exclusive control over the money supply, the Constitution neither expressly affirms nor denies that it should be the province of the federal government to control monetary policy. Yet, in theory, Congress is the most acceptable "constitutional candidate" for controlling the money supply because Article I of the Constitution specifically enumerates the power to coin and regulate the value of money to the federal legislative branch. Specifically, Article I states: "The Congress shall have Power . . . To coin Money, regulate the Value thereof, and of foreign Coin, and fix the Standards of Weights and Measures . . . ."[126]

From an economist's point of view, it makes perfect sense to interpret this as providing Congress with the constitutional authority to set monetary policy and control the money supply.[127] This is because, by definition, the power to regulate the value of money is the lynchpin of monetary policy. The most profound statement of this maxim resides in the economic theory of monetarism, which asserts that monetary policy is directly influenced by the value of money.[128]

Basic monetarist theory posits that changes in the value of money are proportional to changes in the money supply.[129] The theory also maintains that

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126. U.S. CONST. art. I, § 8, cl. 5.

127. Modern investment theory maintains that the money supply is a critical determinant of the level of interest rates in the economy. By definition, interest rates determine the value of money with the general rule being that the higher (or lower) the interest rate, the more (or less) valuable money becomes. For a complete discussion of the connection between interest rates and monetary policy, see ROBERT A. HAUGEN, MODERN INVESTMENT THEORY 310-31 (2d ed. 1990).

128. *See* DORNBUSCH & FISCHER, *supra* note 97, at 667-73. The authors assert that the basic tenants of monetarism focus on the money supply as being determinative of two things: the rate of change in value of money (inflation), and the growth rate of the national economy. *See id.*

129. Although there are many founders of monetarism, Milton Friedman and Irving Fischer have been, by far, the most influential contributors to this school of thought. Friedman, in

the best way to regulate the value of money is by maintaining a gradual, stable rate of growth in the money supply.[130] As earlier observed, this view of monetary policy comports nicely with the text the Constitution, which lists control over the value of money among the powers specifically enumerated to Congress. Could this consistency between monetarist theory and Article I be merely a coincidence? Maybe so. Can it be ignored? Undoubtedly not. Rather, in the absence of any antithetical, constitutional text, it can only be presumed that the Framers, although untrained in monetarist theory, probably intended to assign Congress the responsibility of managing monetary policy when they enumerated the power to regulate the value of money to the legislative branch.

The Framers' minimalist view towards national government strengthens this presumption. Article I is the only provision in the 1788 Constitution that makes express reference to the power to create money and regulate the money supply. Neither Article II, which deals with the President and the executive branch, nor Article III, which deals with the Supreme Court and the judiciary, contains any express reference to this power. This is not surprising. The Framers designed the Constitution with the intention of creating a strong, but limited, national government.[131] To effect this intention, the Constitution established a centralized government that maintained indefinite authority over individual citizens and vested supremacy in the legislative branch.[132] The Framers did not intend for the national government to micro-manage local economic affairs.

Monetarists share in this belief. In their view, the most effective means of establishing monetary policy is by having the central government play only a minimal role in managing the money supply. In short, both the Framers and Monetarists agree that less government is better government regarding the issue of monetary policy.

B. Congress and the Money Supply

The Framers' view and the Monetarists' notion that limited government constitutes the best means for monetary policy suggests that a central banking system in which the national government plays only a small regulatory role, as opposed to the current regime, would more truly realize the philosophical principles contained in the Constitution. Similarly, apportioning the responsibility of monetary policy to the three branches of government would more truly realize the constitutional principle of separation of powers. Hence, the monetarist plan discussed in this Article seeks to achieve both of these aims by proposing a regulatory scheme that reconciles monetary policy with the

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particular, has asserted that the steady growth of the money supply has a stabilizing influence on the national economy. *See* MILTON FRIEDMAN & WALTER W. HELLER, MONETARY VS. FISCAL POLICY (1969).

130. *See id.*

131. *See, e.g.*, William H. Rehnquist, *Point, Counterpoint: The Evolution of American Political Philosophy*, 34 VAND. L. REV. 249, 249-50 (1981).

132. *See id.* at 252.

Framers' constitutional design.

Currently, none of the three branches of the federal government maintains any direct responsibility for monetary policy. Rather, the Federal Reserve implements monetary policy as an independent central bank. However, from a monetarist point of view, the concept of an independent central bank, such as the modern Federal Reserve, may now be an anachronism in light of technological innovations in economic analysis. In 1913, at the time of the Federal Reserve's creation, most elected politicians had neither the technological capacity nor the intellectual training to perform the complex calculations that underlie monetary policy. Rather, only professional economists, highly trained in mathematics and finance, possessed the ability to perform this task. But even in 1913, even most professional economists, though highly trained in theory, were technologically limited in the types of monetary calculations they could perform.

Today, this paradigm has changed. Now, most elected politicians understand economics and finance much better than their counterparts of the early Twentieth Century. In addition, modern economists are now virtually unfettered, in light of the prevailing technology, in the types of mathematical calculations and financial models they can perform and create. Indeed, the use of computers to perform these tasks is now a common part of most undergraduate curricula. With these capabilities, almost anyone can create the basic financial models that the modern Federal Reserve uses to establish monetary policy.[133] Thus, the capacity to formulate sound monetary policy is no longer unique to the Federal Reserve. Instead, due to technological changes and the current political climate, the responsibility of setting monetary policy can be apportioned among the three branches of government. In light of this fact, it may be the appropriate time to rethink the Federal Reserve System in terms of the philosophical and political principles underlying the Constitution. The first step of this undertaking calls for assigning Congress control over the money supply.

1. The Basic Plan.—The monetarist plan proposed in this Article would require the repeal of the statutory provisions underlying the modern Federal Reserve. At first blush, such a proposal may seem radical. But when placed in a historical context, such a proposal is no more extreme than the unprecedented legislation that created the Federal Reserve. Under the monetarist plan, Congress would enact new legislation that provides the federal government only minimal control over the money supply. This legislation would also require Congress, through its subcommittees, to conduct open market operations and set monetary targets on an annual or semiannual basis. Consistent with the monetarist theory, no other intervention would occur between those times. Thus, true to the philosophical and separation of powers principles underlying the Constitution, power over the "value of money" would reside in the federal legislative branch.

2. Three Benefits of the Plan.—

a. Political accountability.—From a philosophical, economic, and political perspective, there are three reasons why assigning Congress control over

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133. *See* DE SAINT PHALLE, *supra* note 32, at 82-83. Historically, Congress has only taken affirmative action in monetary affairs during emergency situations. *Id.* at 83.

monetary policy would function better than the modern Federal Reserve. First and foremost, such control would reincorporate the principle of political accountability into the creation of monetary policy. In its simplest form, the political accountability principle asserts that elected politicians are more responsible to their constituents than appointed officials because the latter are shielded from political pressure, whereas the former are not.[134] Under the monetarist plan, assigning Congress control over monetary policy would make its members more accountable to the public because Congress is a body of elected officials, whereas the modern Federal Reserve is not.[135]

Congress virtually eliminated political accountability from monetary policy when it created the Federal Reserve. Indeed, as exemplified by the Banking Panic of 1907, the fiscal climate at the time of the Federal Reserve's creation promoted banks' self-interests over collective endeavors.[136] For this reason, the American people harbored a great distrust for financiers and politicians with respect to national concerns such as monetary policy. Consequently, it was thought that only an independent agency—one that is shielded from political pressure—could be trusted to put national concerns first. With this in mind, Congress designed the Federal Reserve to function independently from any branch of the federal government.

Today, the fiscal climate in America is much different than it was at the time of the Federal Reserve's creation. While there is still self-interest, modern innovations such as the Internet have facilitated more collective activity. Technology has also made blatant corruption harder to conceal because information becomes public knowledge as soon it is disclosed. In turn, elected politicians are more aware (and concerned) about public sentiment, making it nearly impossible for unilateral corruption to occur. In this new climate, Congress can be trusted to enact sound monetary policy. Accordingly, by making Congress directly accountable to the electorate for its monetary decisions, the proposed monetarist plan has the benefit of incorporating political accountability into monetary policy.

b. Predictability.—Predictability is the second benefit of assigning Congress control over monetary policy. At it stands, the Federal Reserve releases monetary data on a weekly basis. Depending upon whether the statistics are good or bad, financial markets adjust to incorporate the new information. For example, if weekly statistics lead economic analysts to believe that the Federal Reserve will increase the money supply, then financial markets will adjust

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134. The philosophical principle of political accountability originates with Montesquieu and Rousseau. In general terms, the principle asserts that governmental decisions should not be too far removed from the people and that governmental authority, which is not answerable to the people directly, undermines the basic premises of democracy. *See* BARON DE MONTESQUIEU, THE SPIRIT OF THE LAWS 316-30 (Thomas Nugent trans., Hafner Publ'g Co. 1949) (1751).

135. As it exists today, the Federal Reserve is an independent agency whose members are appointed by the President and confirmed by the Senate. Once appointed and confirmed, the members of the Federal Reserve are not directly accountable to any branch of government.

136. *See generally Born of a Panic*, *supra* note 32.

upward. This is because an increase in the money supply leads to a decrease in interest rates, which in turn represents good news to financial markets.[137] The converse is also true. Thus, as the system exists today, economic analysts cannot predict ex-ante the effect that monetary policy will have on financial markets until the Federal Reserve releases its weekly statistics.

The proposed plan will improve the ability of economic analysts to predict movements in financial markets. By limiting the adjustments in the money supply to only annual or semiannual adjustments, the monetarist plan eliminates the present market adjustments that accompany the weekly release of statistics. Analysts will have ex-ante knowledge of the level on a weekly basis. Under monetarist theory, analysts' inaction will have a stabilizing effect on the money supply—the precise goal of effective monetary policy.[138] Thus, by allowing only annual or semiannual monetary adjustments, the monetarist plan improves the predictability of movements in financial markets.

c. *Timing.*—Timing is the third benefit of assigning congressional control over the money supply. Under the prevailing system, a considerable period ordinarily elapses after the Federal Reserve conducts an open market purchase (or sale) before such a transaction has the desired effect on the market. In fact, using empirical analysis, Monetarists have shown that the initial effect of an open market transaction is rather small.[139] However, over time, the effect continues to grow and proliferate.[140] Hence, the timing of open market purchases is a critical aspect of establishing effective monetary policy.

Historically, the Federal Reserve has done a poor job in timing its monetary policy.[141] Indeed, most Monetarists assert that poor timing on the part of the Federal Reserve is the overriding reason that its monetary policies have been ineffective in resolving major crises in the American economy.[142] Consequently, the historical record of the Federal Reserve has led Monetarists to believe that many of the crises in American banking could have been quelled had the Federal Reserve better timed adjustments to its policy.

The proposed plan would eliminate those timing errors. This is because if Congress were to establish monetary policy on an annual or semiannual basis, there would be no intermittent disruptions such as those that occur when the Federal Reserve proactively alters the money supply. In short, once the annual or semiannual growth rate is set, it is final, and Congress can make no further adjustments in policy.

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137. *See* DORNBUSCH & FISCHER, *supra* note 97, at 390-98.

138. For a complete explanation of the efficient market hypothesis, see R. A. BREALEY, AN INTRODUCTION TO RISK AND RETURN FROM COMMON STOCKS 3-61 (2d ed. 1984). According to Brealey, the hypothesis states that "[a] market in which prices reflect [all] available information is known as an efficient market." *Id.* at 25.

139. *See* DORNBUSCH & FISCHER, *supra* note 97, at 445.

140. *See id.* at 445-46.

141. *See* FRIEDMAN & HELLER, *supra* note 129, at 25.

142. *See id.* at 22.

IV. A Monetarist Plan for Presidential Control of Bank Regulation

Article II of the Constitution, unlike Article I, does not specifically enumerate any powers to the President and the executive branch. Rather, the Constitution's clearest statement of executive authority resides in Article II, Section 1, which provides: "[t]he executive Power shall be vested in a President of the United States of America."[143]

Traditionally, the courts have interpreted this provision as giving the President the power to "carry out" and enforce the legislation enacted by Congress.[144] As a practical matter, though, it would be impossible to follow a literal reading of Article II, Section 1 because the President alone cannot personally enforce every enactment of Congress. Instead, the President relies upon executive departments and agencies to assist him in enforcing the law. For the purposes of this Article, the most important powers that the President maintains over those departments and agencies are the powers of appointment and removal. Both powers are discussed in the section below.

A. Appointment and Removal Powers

The President has two checks on the authority of executive departments and agencies: (1) the power of appointment, and (2) the power of removal. As it exists today, members of the Federal Reserve Board are appointed by the President and, as such, they are subject to his power of appointment.[145] However, since the Federal Reserve is an independent agency of the federal government, meaning that it is neither purely executive or legislative, the Supreme Court has held that the President does not possess the absolute power to remove the members of the Board.[146] But historically, the President has maintained unlimited authority to remove the leaders of purely executive agencies.[147]

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143. U.S. CONST. art. II, § 1.

144. The Supreme Court's decision in *Youngstown Sheet & Tube Co. v. Sawyer*, 343 U.S. 579 (1952), is the case most often cited for the proposition that the President, as the sovereign of executive power, can only "carry out" laws, not make them. In that case, the Court concluded that President Truman's executive order to seize and operate steel mills was unconstitutional because it clearly undermined the lawmaking authority of Congress. *See id.* at 558-59.

145. The Constitution provides that the President has the power, subject to the advice and consent of the Senate, to appoint all officers of the United States whose appointments are not otherwise provided for by the Constitution. *See* U.S. CONST. art. II, § 2, cl. 2.

146. The Supreme Court's decision in *Humphrey's Executor v. United States*, 295 U.S. 602 (1935), is the case most often cited for the proposition that the President does not have the unlimited power to remove the head officials of independent agencies.

147. Recently, though, the scope of the President's power to remove purely executive officers has become a very controversial legal question. The Supreme Court's decision in *Morrison v. Olson*, 487 U.S. 654 (1988), is the leading case on the issue. In *Morrison*, the Supreme Court held that Congress may limit the President's power to remove executive officers, unless the removal limitations "are of such a nature that they impede the President's ability to perform his constitutional duty." *Id.* at 691.

B. The President and Bank Regulation

As earlier noted, the Federal Reserve possesses the exclusive authority to regulate the activities of its member banks and bank holding companies. It also maintains the independent power to influence the purely executive agencies that regulate banks. However, from a constitutional point of view, direct Presidential control over regulation of banks and bank holding companies is more consistent with the broad, extensive mandate of Article II of the Constitution than it is with the independence currently maintained by the Federal Reserve. Accordingly, the monetarist plan proposed in this Article posits that the President, through a new, purely executive agency known as the Department of Monetary Affairs (DMA), is a better constitutional candidate for regulating banks and other aspects of monetary policy than is the modern Federal Reserve.

Under the monetarist plan, the DMA would possess three structural characteristics: First, the President, with the advice and consent of the Senate (Article II, Section 8), would have the unlimited power both to appoint and remove the Chairman of the DMA. Second, the Chairman of the DMA would serve a four year term that would run concurrently with the President's term of office. The Chairman would also supervise all agencies responsible for bank regulation. Third, the DMA, like the modern Federal Reserve, would have the power to adjust interest rates and reserve requirements.

The purely executive DMA would fit nicely within the Framers' constitutional architecture of a Congress, which has the power to enact legislation, and a President, who has the authority to enforce legislation.[148] Because the functions of the DMA would be purely executive in nature, and thus under the exclusive authority of the President, Congress could not use the power of removal to influence the decisions of the DMA.[149]

In addition, the monetarist plan would enable the President and the Chairman of the DMA to coordinate their policies regarding bank regulation.[150] With the existing system, policy coordination cannot be achieved because the President

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148. *See* THE FEDERALIST NO. 51 (James Madison) (Clinton Rossiter ed., 1961). On the issue of maintaining separate legislative and executive branches of government, Madison states:

> In order to lay a due foundation for that separate and distinct exercise of the different powers of government, which to a certain extent is admitted on all hands to be essential to the preservation of liberty, it is evident that each department should have a will of its own; and consequently should be so constituted that the members of each should have as little agency as possible in the appointment of the members of others.

Id. at 321.

149. The Supreme Court's decision in *Buckley v. Valeo*, 424 U.S. 1 (1976), is the case most often cited for the proposition that Congress has no constitutional right to appoint officers of the United States where the responsibilities fulfilled by those officers are executive in nature.

150. For a detailed discussion about coordination among executive agencies, see STEPHEN G. BREYER & RICHARD B. STEWART, ADMINISTRATIVE LAW AND REGULATORY POLICY 105-08 (3d ed. 1992).

and the Federal Reserve Chairman serve non-concurrent terms of office.[151] Coordination is also hindered because the Federal Reserve is only one of many agencies that regulates the banking industry.[152] In contrast, the monetarist plan establishes concurrent terms of office for the President and the Chairman of the DMA. It also assigns control of all agencies to the executive branch. Hence, the coordination problems germane to the current system will be greatly reduced under the monetarist plan.

Consistent with the Framers' design, the monetarist plan also provides a constitutional check against Congress' monetary enactments by empowering the President to adjust reserve requirements and the discount rate. Like the veto power,[153] Presidential control over discount rates and reserve requirements would enable the President to monitor Congressional enactments because discount rates and reserve requirements, as noted earlier, have the same effect on the money supply as open market operations. With this power, the President could make emergency adjustments to Congress' annual legislation in the event of a financial crisis. The President does not have this power vis-a-vis the modern Federal Reserve. Accordingly, the monetarist plan represents an improvement upon the existing system because it establishes an executive mechanism to check monetary policy.

CONCLUSION

The evolution of monetary policy and bank regulation, like the Constitution, is a product of historical forces—the progeny of many governmental institutions that were given form and substance because of political responses to financial crises. Indeed, just as the anticipated role of Bank of the United States exceeded the opaque vision of its creators, the modern Federal Reserve has transcended the limitations of its original design. Historical accidents, such as the brilliant innovations of Benjamin Strong and Marriner Eccles, contributed greatly to the Federal Reserve's development. Yet, nothing in the Constitution or the Federal Reserve Act gave the Federal Reserve the extensive control over monetary and bank regulation that it exercises today.

The monetarist plan proposed in this Article seeks to reallocate the powers of the Federal Reserve in a manner that is more consistent with the Framers' conception of national government. Although the Framers were without the benefit of monetarist theory, their view of limited national government is strikingly similar to the Monetarists' view of minimal intervention. In particular,

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151. Under the current system, the members of the Federal Reserve Board serve terms of fourteen years. *See Born of a Panic*, *supra* note 32.

152. There are seven agencies in the United States that have some control over bank regulation: The Federal Reserve, Comptroller of the Currency, Federal Deposit Insurance Corporation, The Federal Home Loan Bank System, The Federal Savings and Loan Insurance Corporation, The National Credit Union Administration, and The National Credit Union Share Insurance Fund. *See* DE SAINT PHALLE, *supra* note 32, at 15.

153. *See* U.S. CONST. art. I, § 7, cl. 2.

both the Framers and Monetarists agree that the best way to secure stable economic growth is by keeping government regulation to a bare minimum.

In addition, while the Framers never anticipated the need for centralized control of monetary policy and bank regulation, it is the responsibility of lawmakers to preserve the Framers' intention that constitutional power reside securely within three branches of government. The monetarist plan proposed in this Article restructures monetary policy and bank regulation to fit the Framers' architecture by relying upon the philosophical and political principles calling for separate governmental branches. In so doing, it embraces the advent of the new financial and technological innovations that have accompanied the change in times.

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LECTURE

THE BACKLASH AGAINST MANAGED HEALTH CARE: HARD POLITICS MAKE BAD POLICY

McDonald-Merrill-Ketcham Lecture[*]

CLARK C. HAVIGHURST[**]

> And there is nothing more difficult to take in hand, more perilous to conduct, or more uncertain in its success, than to take the lead in the introduction of a new order of things. Because the innovator has for enemies all those who have done well under the old conditions, and lukewarm defenders in those who may do well under the new. This coolness arises partly from fear of the opponents, who have the laws on their side, and partly from the incredulity of men, who do not readily believe in new things until they have had a long experience of them.
>
> Niccolo Machiavelli, *The Prince* (1513)[1]

It is now old news that managed health care—once viewed as a highly promising, consumer-friendly movement—has encountered a serious backlash in public opinion.[2] Although it was predictable that the public would eventually come to question the premises of managed care, I doubt if anyone anticipated a reaction as vehement as the one we have seen. Beginning with an increasing flood of media anecdotes and editorial criticism, it seemed to culminate when movie audiences throughout the country applauded an anti-HMO expletive by the actress Helen Hunt in the 1997 film *As Good As It Gets*. At that point, it became clear that something unusual was going on and that managed care was going to provide an interesting test of the political system.

Although some of the criticism directed at HMOs was fair, cheap shots were

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1. Quoted in RAND Corp., 1998 Calendar.

2. *See, e.g.*, Special Issue, *The Managed Care Backlash*, 24 J. HEALTH POL., POL'Y & L. 873 (1999).

very common. Many stories did not warrant even on their face—at least for those who appreciate the problematic nature of many medical decisions and the need to take trade-offs between benefits and costs into account in health care as in other endeavors—the intended implication that health plans were acting irresponsibly in managing resources.[3] Journalists were usually quick to play on people's natural concern about their health care without observing the shortcomings the old system of health care financing or the accomplishments of managed care in introducing new rationality and restraint into medical decision making. Significantly, health care's share of the nation's gross domestic product (GDP), after rising steadily at burdensome rates for many years (claiming an additional .37 of a percentage point of GDP, on average, each year from 1980 to 1993), stopped rising altogether in 1993 and remained essentially level at around 13.6 percent for six years, through 1998.[4] How much of this relief from rising costs was attributable to better management of clinical medicine is debatable,[5]

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3. One influential tale peddled by critics of managed care, for example, concerned the Kaiser-Permanente HMO in Atlanta, which sent an infant with a dire condition to a distant hospital for a middle-of-the-night emergency. Yet the sad outcome in that case apparently resulted, not from HMO profiteering at the expense of patient health, but from a simple miscommunication between the child's mother and Kaiser's nurse on the other end of the telephone. Indeed, the muckraking journalist who used a lengthy, heart-wrenching rendition of this story to lead off a book broadly attacking HMOs also revealed (136 pages later, in another connection) how a Colorado phone bank, established to field similar late-night calls to HMOs around the country, handled an identical case within fifteen seconds by instructing the mother to call 911. *See* GEORGE ANDERS, HEALTH AGAINST WEALTH: HMOS AND THE BREAKDOWN OF MEDICAL TRUST 1-13, 149 (1996). To be sure, all systems break down from time to time, but that is no argument against building systems. For every miscommunication like the tragic one in Atlanta, thousands of anxious parents are given help and reassurance in the middle of the night, and emergency rooms are kept clear of unnecessarily worried individuals, enabling them to treat true emergencies faster and better.

4. *See* Katharine Levit et al., *Health Spending in 1998: Signals of Change*, HEALTH AFF., Jan.-Feb. 2000, at 124, 125 (ending up actually lower in 1998 than in 1993, 13.5 % versus 13.7%). To be sure, GDP itself rose rapidly over this period, easily absorbing the rise in health costs that did occur. But this cause of the apparently improved performance may also be an effect. Thus, the reduction in health care's demands for new resources may itself explain some of the extraordinary growth of the overall economy in the 1990s. The savings from managed care are often denigrated as "one-time savings," and some critics of managed care take satisfaction in noting that employer costs are rising once again. Yet the six-year plateau meant that, even if health care costs now resume their earlier rate of increase (arguably a function of normally increasing demand and the appearance of new, desirable technologies), spending would still be at a lower level than it would have been, representing a recurring saving year after year. Unfortunately, people have a tendency to ask what managed care has done for them lately and not to appreciate its continuing contribution as a check on inefficient spending.

5. *See, e.g.*, Daniel Altman et al., *Enrollee Mix, Treatment Intensity, and Cost in Competing Indemnity and HMO Plans*, NBER WORKING PAPER SERIES (Aug. 2000), *at* http://www.nber.org/papers/w7832 (reporting how HMOs serving one pool of public employees in Massachusetts achieved savings almost exclusively by enrolling better risks and paying less to

but managed care was also helpful in other ways, such as in improving the accessibility and continuity of care and in making competition an effective check on providers' fees and charges. Also, despite a concern that many have expressed, no clear evidence demonstrates that HMOs have lowered the overall quality of care.[6] If the full truth had been told, the managed care story, while not an altogether happy one, would have included more good news than bad.

But, however the benefits and costs of managed care balance out in reality, the fact remains that some very important innovators in the health care system are having an exceedingly rough time in the court of public opinion. These innovators have discovered the truth observed by Machiavelli—that introducing "a new order of things" can be "perilous." Indeed, Machiavelli's observation describes quite well where the managed care revolution stands today. Revanchist physician interests ("those who have done well under the old conditions" and "have the laws on their side"[7]), aided by attention-seeking journalists, opportunistic politicians, self-styled consumer advocates, and plaintiffs' lawyers sensing HMOs' blood in the water, have mounted what is turning out to be a very effective counter-revolution. On the other hand, consumers ("those who may do well under the new" methods of purchasing health services but "do not readily believe in new things until they have had a long experience of them") are highly suspicious of managed care and have not rallied to its defense, even as "lukewarm defenders." Those who advocate carrying the revolution forward—a class limited largely to major employers and the beleaguered managed care industry itself—are finding it hard to resist the counter-revolutionary tide.

In this lecture, I want to suggest why the backlash against managed care is so powerful and why the signals the public is sending to policy makers are misleading as indicators of the true nature of the problems that need somehow to be solved. After demonstrating in a somewhat formal way the likelihood that

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providers, not by reducing "treatment intensity").

6. *See* R. Adams Dudley et al., *The Impact of Financial Incentives on Quality of Health Care*, 76 MILBANK Q. 649, 673 (1998) (finding "little evidence of any consistent difference in clinical quality between [fee-for-service] and HMOs"); Robert H. Miller & Harold S. Luft, *Does Managed Care Lead to Better or Worse Quality of Care?*, HEALTH AFF., Sept.–Oct. 1997, at 7, 13–14, 20–22. According to these sources, quality improvements in some areas apparently offset adverse effects in a few areas where things are arguably worse (such as treatment of chronic conditions). On the other hand, managed care has not improved quality overall, which it might reasonably have been expected to do—and might do under a different legal regime. *See infra* text accompanying notes 39-43.

7. In suggesting that opponents of HMOs "have the laws on their side," Machiavelli obviously failed to anticipate the Employment Income Security Act of 1974 (ERISA), 29 U.S.C. § 1001 (2000), which, by preempting certain state regulation, has sheltered much useful innovation in purchasing health services that would otherwise have been stifled by state law and associated litigation threats. In all other respects, however, Machiavelli was correct. The legal system generally embodies the professional paradigm of medical care and universally employs professionally developed standards as benchmarks for evaluating HMOs and determining patient entitlements. *See infra* note 19 and accompanying text.

legislators will enact excessive regulatory measures to appease unhappy consumers, I define the public policy challenge as one of finding nonprescriptive ways to enable managed care plans to achieve the legitimacy they so badly need in order to serve consumers well. To this end, I offer some policy suggestions for putting the managed care revolution on a somewhat different and more secure track.

I. Managed Care and Public Opinion

Throughout the 1980s, the managed care industry enjoyed something of a honeymoon with the general public. To be sure, occasional public relations problems arose, including the disclosure of the astounding compensation, during that era, of some HMO executives. But the promised cost savings, together with the enthusiasm of both employers and policy wonks, generally obscured the tensions inherent in the concept of managed care. Moreover, the number of consumers enrolled in HMOs was still relatively small, and many of them had enrolled voluntarily and retained the option of returning to the unconstrained fee-for-service system if they were dissatisfied. Under these circumstances, few complaints were heard. Managed care plans naturally came to assume that the public appreciated their efforts and accepted their methods as the wave of the future.

By the mid-1990s, however, the honeymoon was over. Predictably, the romance began to go out of the relationship once the public and the managed care industry had to face the divisive realities of health care economics. As the price gap between managed care and traditional coverage widened, more and more consumers were forced into a managed care plan because of its lower cost to their employers, without appreciating that limitations might be placed on their choices and their doctors' clinical options. Suddenly, managed care horror stories found larger audiences, and the anecdotes began to accumulate. Physicians, to say the least, did nothing to calm patients' fears.

At the same time, consumers had more and more reasons to be nervous about HMOs, as some cost-control efforts began to go beyond merely trimming fat from the edges of the system and started to cut into what might be seen as beneficial care. Initially, reducing health care costs was easy. Plans needed only to use their strategic positions vis-a-vis providers to squeeze provider incomes and to eliminate services that everyone agreed yielded no patient benefit—those undeniably on the "flat of the curve." In due course, however, pressures from purchasers to keep costs down induced attention to benefit/cost ratios where the numerator was not obviously zero. Health plans thus seemingly began to fight the battle for cost containment in the benefit/cost no-man's land, where anyone trying to control costs is dangerously exposed to sharpshooting journalists, politicians, and trial lawyers.[8] Indeed, while managed care stabilized health

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8. For a graphic illustration of the no-man's land, see CLARK C. HAVIGHURST, HEALTH CARE CHOICES: PRIVATE CONTRACTS AS INSTRUMENTS OF HEALTH REFORM 94 (1995); Clark C. Havighurst & James F. Blumstein, *Coping with Quality/Cost Trade-offs in Medical Care: The Role*

care's share of GDP from 1993 to 1998, that stability became harder to maintain each passing year because of the natural tendency of health care costs to rise much faster than GDP. As expensive new technologies and treatment options continued to appear, costs could be kept in line only by imposing increasingly strict constraints. All these factors contributed to gradually increasing consumers' fear that managed care might deny them beneficial care—which they had come to see as their entitlement, whatever the cost.

It is important to ask what precisely is behind consumers' current fears. Does public opinion accurately reflect the true situation? Or is this just another case of spoiled Americans demanding entitlements for which they are not prepared to pay the cost? Most likely, people's fears reflect, more than anything else, a sense that they have had very little say in the process by which the old, reassuring health care system was replaced by something else.[9] If such a feeling of disempowerment is indeed the source of consumer discontent, then even market-oriented policy makers should be concerned. For if consumers do not feel they have the power to choose a health plan that suits their needs, or if they feel a particular choice has been forced on them, the market cannot be said to be serving its usual democratic function. The market outcome—whatever people find themselves stuck with *ex post*—cannot plausibly be said to be validated, even presumptively, because people had an opportunity to choose *ex ante*. Lacking the legitimacy that choice, deliberately exercised, confers in a democratic system, managed care firms cannot reasonably hope to deflect criticism when their practices cause discontent.

Consumers have several good reasons for feeling disempowered in the current health care marketplace. First, even when they are offered a set of health plan options, they find it is almost impossible to distinguish between them, to know how responsive and generous each plan intends to be when a health need arises.[10] Thus, it is difficult for consumers to shop for a plan that reflects their personal trade-off between the quality and cost of coverage. Today, all health plan contracts promise that the plan will pay for, or provide, all "medically necessary" care, but contemplate that the plan itself will decide just what is "necessary" in a particular situation. In 1995, I published a book suggesting the

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of PSROs, 70 NW. U. L. REV. 6, 16-17 (1975) (providing same diagram with fuller elaboration).

9. *See* Atul A. Gawande et al., *Does Dissatisfaction with Health Plans Stem from Having No Choices?*, HEALTH AFF., Sept.-Oct. 1998, at 184 (finding substantial correlation between dissatisfaction and lack of choice); Beiyao Zheng et al., *Patients' Trust in Health Insurers: Development of an Insurer Trust Scale*, HEALTH SERV. RES. (forthcoming 2001).

10. A complexity is added by the adverse selection that can occur when a patient with a specific health need seeks the plan that provides the most generous coverage for that need. Rather than arming consumers with the ability to shop to meet a specific need, the goal should be to offer clear choices between more and less generous plans. The adverse selection problem can be ameliorated by, among other things, allowing plans to limit their coverage of "pre-existing conditions"—reserving, for example, the right, for a period of time, to invoke contractual limits in a new subscriber's previous health plan, thus discouraging consumers from upgrading their coverage as soon a specific health need arises.

rewriting of health care contracts so that they would actually tell the consumer something useful about what he could expect from his health plan and so that their terms could be enforced with some precision against one party or the other if an issue arose.[11] As long as contracts remain as opaque as they are today, consumers will feel unable to make informed decisions, and they will not readily accept the consequences of their choices.

Another reason consumers feel disempowered in today's health care marketplace is that most receive health benefits through their employers rather than by purchasing a plan for themselves. Group purchasing makes sense in many respects, and employers are reasonably effective agents for consumers seeking coverage. But employment groups are not the only vehicles by which individuals might obtain group health benefits. One can imagine, for example, individuals buying health care coverage through such intermediaries as professional or fraternal groups, churches, unions, or purchasing cooperatives. Indeed, it is only because the generous federal tax subsidy for health coverage applies only when coverage is purchased through an employment group that nearly all employed Americans get whatever coverage they have by that route. If the tax subsidy were made available in a different form (perhaps as a credit for coverage purchased by any means), consumers would have less reason to feel oppressed by choices made by their employers.[12]

Consumers' dissatisfaction with health coverage purchased through employment groups can be further understood as an especially troublesome instance of a significant difficulty encountered in most collective decision making. In any collectivity, some individuals' preferences will diverge significantly from the group norm. Some will be forced by a group purchasing decision to pay more than they would choose to pay for the good or service in question, while others will receive less of the collectively provided item, or lower quality, than they would willingly pay for. Some degree of unhappiness is therefore inevitable. In the case of employer-purchased group health coverage, however, people who in fact are paying more than they would choose to pay are not likely to complain because they are unaware how much they are paying or how costlier coverage affects their take-home pay.[13] On the other hand, those who sense they are receiving less health protection than they desire *can* be expected to complain. Moreover, in addition to those prepared to pay for Cadillac coverage and fearing they are getting something less, there is another

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11. *See* HAVIGHURST, *supra* note 8 (arguing that, although the difficulty is undeniable, better contracts could be written and probably would be if judges were more even-handed in interpreting and enforcing contracts that are less generous than they would like them to be).

12. *See* Stuart Butler & David B. Kendall, *Expanding Access and Choice for Health Care Consumers Through Tax Reform*, HEALTH AFF., Nov.-Dec. 1999, at 45; Mark Pauly et al., *Individual Versus Job-based Health Insurance: Weighing the Pros and Cons*, HEALTH AFF., Nov.-Dec. 1999, at 28; *see also infra* note 25.

13. It is common knowledge among economists that the cost of fringe benefits falls mostly on employees, not employers. *See* Linda J. Blumberg, *Who Pays for Employer-sponsored Health Insurance?*, HEALTH AFF., Nov.-Dec. 1999, at 58.

group of complainers—probably a very large one—who feel their coverage is less than ideal but who would not in fact be willing to pay the higher price of better coverage. These latter malcontents cannot see, and thus do not appreciate, the substantial cost savings they have derived from managed care—which accrue to them, unlabeled, in larger paychecks. Instead, they see only what they fear (with or without a substantial basis in fact) is a drastic diminution in the health coverage they previously enjoyed. As typical Americans, a substantial number of them will think they are being shortchanged. And there are plenty of people (physicians, consumer advocates, politicians, and journalists) who will encourage them in that belief.

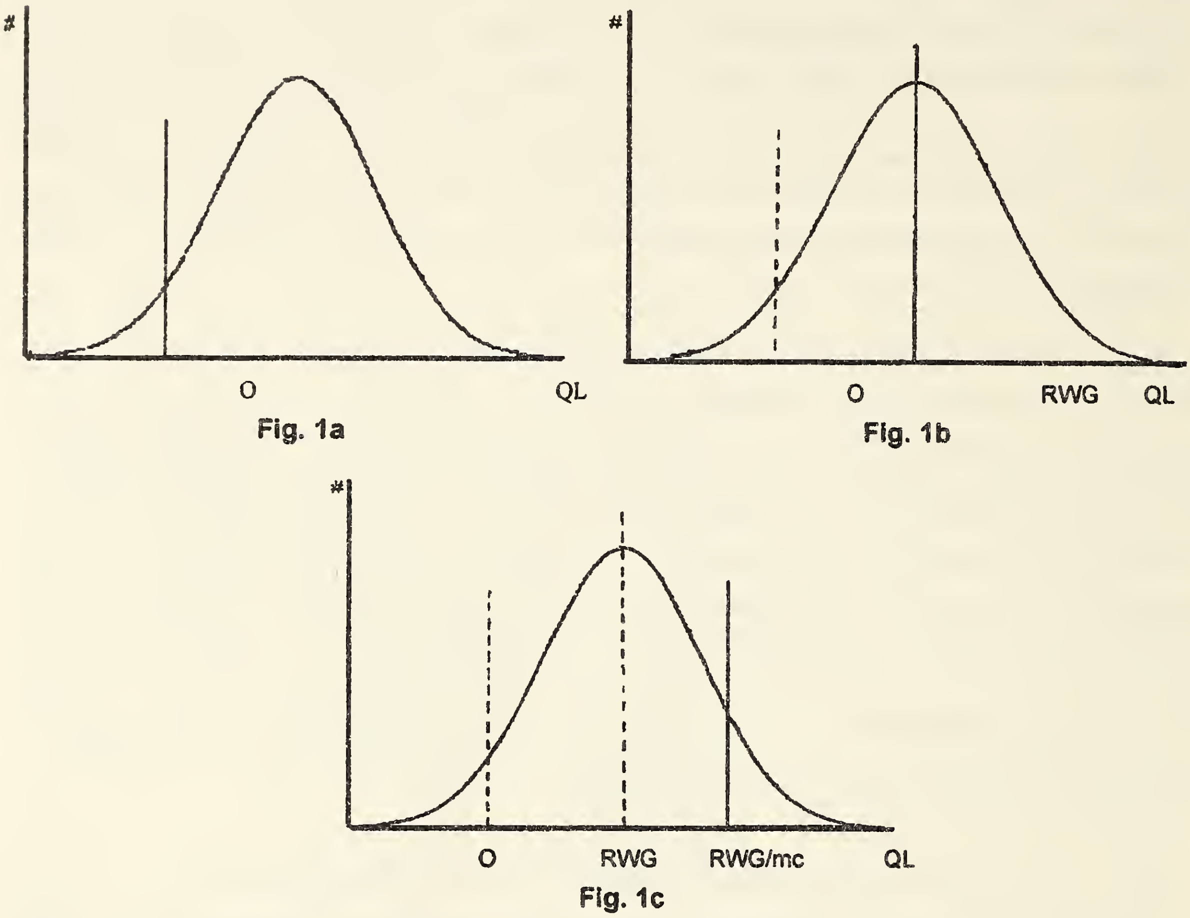
The latter two groups of dissatisfied consumers—both those willing to pay more but denied the opportunity and those who feel entitled to Cadillac coverage even though they are not prepared to pay for it—focus their grievances on the poor managed care plan or on the employer who opted for managed care in providing self-insured coverage. More importantly, these disgruntled consumers are also contributing to the strong political pressure on legislatures and other arms of government (from state attorneys general to insurance commissioners to courts) to "do something" about managed care. This pressure reflects not only well-founded consumer dissatisfaction but also grievances arising only from consumers' poor information, unrealistic expectations, and lack of direct involvement in purchasing their own health care. Government's most natural response to this backlash is to impose new regulatory burdens—overregulation—on HMOs and other managed care entities.

II. The Political Economy of Managed Care Reform

The current pressure on government to dictate generous terms and costly administrative requirements for private health coverage is heightened by the same kinds of problems in collective decision making that I have identified as a source of discontent over employer-financed health coverage. Once again, the costs of the choices to be made—in this case by legislators or regulators rather than employers—are effectively hidden from the voters, who as consumers must ultimately pay them. In addition, any collective decision will inevitably, just as in the employment setting, override the preferences of many members of the group—in this case the polity itself. Those who would be ill-served by the regulatory choice include both those wanting to buy economical coverage of the kind that regulation would preclude and those wanting even stricter regulation—to reduce or eliminate the risk that any health coverage they (or their employer) might purchase would be below the level of quality they desire. As in the case of employer-purchased coverage, the preferences of consumer-voters will be distorted by their poor awareness of what incremental improvements in health coverage actually cost.

A simple model can illustrate the pernicious potential of collective decisions affecting, directly or indirectly, the quality of health coverage—that is, its scope, generosity, and dependability. Consider the bell curve pictured in Figure 1.

Figure 1. The Distribution of Quality in an Unregulated Market and Some Regulatory Possibilities



This bell curve hypothetically illustrates the number of units (x-axis) of each level of quality (y-axis) that consumers of any product might choose (with good information) to purchase in an unregulated market—high quality (BMWs) to the right, lower quality (Yugos) to the left. Regulation can be seen as eliminating certain low-quality options from the market—everything to the left of the line drawn at point *o* in Figure 1a, for example. There is, in theory, an optimal cut-off point below which some consumers could appropriately be denied their first choice. Thus, the line at point *o* might be the regulatory standard under which the aggregate savings to all consumers, both from (1) reducing their costs in searching the market (to avoid making an erroneous purchase) and (2) preventing the occasional injuries that low-cost products would cause, would most exceed the costs attributable to regulation. The costs of regulation that must be compared to its benefits include not only the administrative costs of the regulatory program itself but also the costs to those consumers who are forced to pay more than they would have chosen to pay. More ominously, an additional cost of regulation must also be counted—namely, the adverse consequences to those consumers who, instead of paying the higher price, choose to forgo the item altogether. One study of occupational licensure, for example, showed that setting minimum standards for licensing electricians caused an increase in the number

of accidental electrocutions—as some do-it-yourselfers paid the ultimate price.[14] All these costs of regulation need to be taken seriously, since they may easily outweigh the gains from ensuring that no goods or services of a quality below the regulatory floor are delivered.

Even though it is possible to set as a point *o* a regulatory minimum standard under which consumers in the aggregate would enjoy a net welfare gain, that fact alone does not justify such standard-setting, command-and-control regulation. One must also consider whether real-world governments can be expected to choose anything close to the optimal cut-off point on the bell curve. Unfortunately, it is likely, even predictable, that the cut-off actually chosen by democratic government would be close to the standard signified by the line drawn at point *RWG* (for "real-world government") in Figure 1b. The reason, obviously, is that, at least in democratic theory, the majority rules. Specifically, the political majority of would-be purchasers to the right of point *RWG*—persons who prefer (and are able to pay for) high quality—would almost certainly demand a higher regulatory cut-off than would be optimal, thus saving themselves even more search and other costs than they would save if the regulatory standard was set at point *o*. Indeed, there are reasons why the standard actually set might be higher still. Consumers on the right-hand side of the preference distribution are, after all, the most aware, affluent, influential, and politically active members of the population in addition to being well represented in the media and in policy-making elites. There would also undoubtedly be, in most cases, politically influential industry or professional groups that also prefer, and can fight effectively for, high standards as a way of increasing demand for their services and eliminating low-cost competitors.[15] Even if other interest groups provide some countervailing pressure against high regulatory standards, the coalition of upper-middle-class voters and other special interests pressing for such standards may be powerful indeed.

Now let us look at Figure 1 in light of the managed care debate itself to see

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14. *See* Sidney L. Carroll & Robert J. Gaston, *Occupational Restrictions and the Quality of Service Received*, 47 SO. ECON. J. 959, 965 (1981).

15. Although professional influences are usually blamed for excesses in occupational licensing, a classic 1963 article on medical economics observes as follows:

> The general uncertainty about the prospects of medical treatment is socially handled by rigid entry [i.e., physician licensing] requirements. These are designed to reduce the uncertainty in the mind of the consumer as to the quality of product insofar as this is possible. I think this explanation, which is perhaps the naive one, is much more tenable than any idea of a [medical] monopoly seeking to increase incomes. No doubt restriction on entry is desirable from the point of view of the existing physicians, but the public pressure needed to achieve the restriction must come from deeper causes.

Kenneth J. Arrow, *Uncertainty and the Welfare Economics of Medical Care*, 53 AM. ECON. REV. 941, 966 (1963) (citation omitted). *See also id.* at 953 ("[I]t would usually happen in a competitive market that many qualities will be offered on the market, at suitably varying prices, to appeal to different tastes and incomes. Both the licensing laws and the standards of medical-school training have limited the possibilities of alternative qualities of medical care.").

why the threat of overregulation of managed care by "RWGs" is especially severe. We have already seen that the middle-class majority is actively demanding regulatory protection against what they perceive (mostly misguidedly) to be poor-quality health coverage. Many of these voters are apt to believe that the cost of the coverage they wish to have guaranteed by regulation will be paid by their employers rather than themselves. It is therefore possible, even probable, that the regulatory line that upper-middle-class voters (with strong support from the medical profession and other supply-side interests) would encourage legislatures to draw would be well to the right of even the already inefficient point *RWG*. Indeed, because these dynamics have been at work for a long time, existing law and regulation (and the powerful litigation threats associated with them) probably already put a supermajority of consumers in a position where, without realizing it, they are forced by law, and by the professional standards of practice that the law incorporates,[16] to pay for much more and more costly health care than they would purchase if they had clear and meaningful choices and were spending their own money (even with appropriate public subsidies). There is thus good reason to believe that managed care and personal health care generally are already being regulated even more inefficiently than is "normal" for RWGs, which will in any event tend to set high regulatory standards to suit upper-middle-class consumers and professional interests, leaving the lower-income minority to fend for themselves. The recent political backlash against managed care threatens to push RWGs to raise regulatory standards further still—to, say, the line drawn at point *RWG/mc* in Figure 1c.

Perhaps the most suggestive evidence for my claim that health care law and regulation have already drawn prescriptive lines well beyond even the line at point *RWG* in Figure 1b is that the level of spending on health care in the United States, even after stabilizing for several years after 1993, still exceeds spending in any other nation by several whole percentage points of GDP.[17] With U.S. GDP approaching $10 trillion, each of these three or four percentage points represents nearly $100 billion in arguable overspending. Moreover, the absence in the United States of universal health insurance comparable to that found in other nations further underscores how the United States disproportionately allocates resources to providing mainstream health care for the middle class. As I have tried to show, the content, intensity, and cost of this care are dictated less by true consumer preferences than by legal and regulatory standards favored by upper-middle-class voters and professional interests. Although advocates of still more regulation can usually claim that their new prescriptions will not cost the public very much, they are counting only the incremental costs that the new rules would lay on top of costs already mandated by pervasive overregulation. It is

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16. For observations and materials relating to professional standards as (costly) legal standards, see CLARK C. HAVIGHURST ET AL., HEALTH CARE LAW AND POLICY: READINGS, NOTES, AND QUESTIONS 191-204, 999-1070, 1228-38 (discussing malpractice law and coverage issues) (2d ed. 1998). *See also* HAVIGHURST, *supra* note 8, at 111-17.

17. *See* Gerard F. Anderson & Jean-Pierre Poullier, *Health Spending, Access, and Outcomes: Trends in Industrialized Countries*, HEALTH AFF., May-June 1999, at 178.

remarkable how little political or academic concern is expressed about the possibility that the nation is misallocating hundreds of billions of dollars each year to health care at the expense of people's other needs and aggregate welfare.[18]

Advocates of regulation also never seem to recognize the impact of their proposals, or of the heavy expectations already built into American law and regulation, on the more than forty million Americans who lack any form of health coverage. Like regulating electricians, however, using regulation to marginally improve the services the political majority can expect to receive from managed care plans can have disastrous consequences for those who find it difficult to provide for their families.[19] Moreover, in addition to putting the cost of health coverage out of reach for many citizens, overregulation also effectively precludes public provision of a universal entitlement. The well-off majority, content with their own high-quality care, have long proved themselves unwilling to be taxed at the level necessary to finance an entitlement to similar care for the millions who lack it. An unfortunate feature of American health policy is that the people who most bemoan the plight of the uninsured are also apt to insist on maintaining the high regulatory standards that make it politically impossible to finance a basic entitlement for all. Even if these advocates are personally prepared to pay substantial taxes to finance the same high-quality coverage for everyone, their twin commitment to both ideals—high standards and egalitarianism—does them no credit if, because it is politically impossible to realize both ideals, many lower-income people are left with no coverage at all.

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18. *See* HAVIGHURST, *supra* note 8, at 91-92:

> [I]t is cost increases, not the attained level or character of spending, that occasion most complaints and most political pressures for government intervention to control costs. Even if all spending were undeniably appropriate, the complaints about rising costs might be no less loud. Conversely, if costs were stabilized, there might be no overt complaints, even if the industry were wasting a significant portion of [the nation's] GDP on activities yielding too few benefits to justify their costs.

19. See the following observation by Judge Richard Posner, dissenting from a denial of a hearing en banc in *Moran v. Rush Prudential HMO, Inc.*, 230 F.3d 959 (7th Cir. 2000), an ERISA preemption case allowing a state to require HMOs to provide reviews by independent physicians of the plan's coverage denials:

> The Illinois law thus adds heavy new procedural burdens to ERISA plans. These burdens do not come without cost. The expense of an arbitration by the independent physician could easily equal the expense of the medical treatment that the HMO had refused to authorize. Piling on costs in the administration of ERISA plans will shrink benefits and deter some employers from offering health insurance at all. In addition, the Illinois law obviously is intended (responding to the recent torrent of criticisms of HMOs) to tilt the administration of those plans in favor of participants by giving them an additional remedy . . . .

Id. at 173-74. Note that Judge Posner focuses only on the administrative costs of the regulatory requirement and not on its delegation of final responsibility to medical professionals having no responsibility for the cost of the coverage they are in a position to mandate.

The burdensome impact of majoritarian overregulation of the health care sector on citizens whose circumstances and preferences are illustrated by the left-hand portion of the bell curve in Figure 1 does not stop with the uninsured. After all, when individuals accept employment without health coverage as a fringe benefit, they have in some sense made a market choice to take their full compensation in cash (and their chances with respect to health care). On the other hand, those who choose employment that does carry health benefits, although they may make the rest of us feel better, are not themselves necessarily any better off than the uninsured. Instead, they are likely to be sacrificing many other good things of life in order to pay for coverage that, because of either employer choice or law and regulation, is substantially more costly than adequate health coverage has to be.

To appreciate the magnitude of the burden that upper-middle-class health coverage places on low-income employees, consider the example of my own employer. At Duke University, an hourly-paid worker earning $30,000 a year can obtain health coverage that costs, nominally at least, $6535 for a family (that is, $545 each month or eighteen percent of the worker's total pretax compensation, excluding other fringe benefits).[20] Although even more costly options are available, Duke employees do not have the opportunity to spend any less on health care and take the full savings in increased take-home pay. Most low-income employees therefore accept health benefits that were designed principally to meet the needs of the university's faculty and administrators. The situation at Duke is in many respects a microcosm of the national situation, in which regulatory prescriptions, professional standards, tax subsidies, and employer-dictated terms of coverage all ensure that health plans are designed to suit the preferences of the privileged minority and the interests of health care providers, thereby denying ordinary people the freedom to spend their limited incomes in ways that maximize their welfare.

There is a final insult added to this injury. Even though high standards set by law and contract appear to benefit all health plan enrollees equally, equal entitlement does not guarantee equitable allocation of benefits. Indeed, regressive cross subsidies would result if more educated, articulate, and demanding upper middle class enrollees consistently obtained more and better services than lower-income persons paying the same premiums.[21] Although there

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20. This is the sum of the employee's monthly payroll deduction and what Duke quotes as its own contribution. For a younger worker at least, this quoted cost is somewhat overstated, both as an actuarial matter and in terms of the wages the employee actually forgoes in order to have health coverage. *See* Pauly et al., *supra* note 12, at 32 (citing research showing that some younger individuals switching to employment without health coverage did not receive compensating increases in their wages equal to the per-employee cost of the first employer's coverage).

21. Some years ago, Duke merged its health plan for its hourly personnel with its plan for faculty and staff. Although this was generally perceived as a progressive move, its effect, ironically, was to lower premiums for the latter employees and increase the premiums for hourly workers. Obviously, the high utilizers in the faculty-staff plan enjoyed a windfall at the expense of the lower-paid employees, a situation that may continue unrecognized to this day.

appear to be no studies establishing whether inequity of this precise kind is pervasive under managed care, it seems likely that any system can be "worked" better by some patients than by others. Moreover, some of the inequities that have been observed in medical care are consistent with the hypothesis that physicians and administrators, rather than distributing services strictly according to patients' medical needs, systematically treat some patients as more equal than others.[22] Although commentators usually attribute any inequity to racism or intentional discrimination against low-income persons, unfairness in the allocation of funds pooled by consumers to pay for health services might result simply from a natural tendency to accommodate the expectations of individual patients—higher or lower, expressed or perceived, as the case may be.[23] In any event, any greater ability of higher-income individuals to get more out of their health plans than ordinary people do exacerbates the inequity previously observed in the limitations placed by law and regulation on the health care options of low-income consumers.

Observe again how political elites keep the cards stacked against the low-income consumer. Politicians, journalists, lawyers, and academic observers can all be expected to blame the system whenever discrimination of any kind comes to light and to advocate strong legal sanctions and regulatory controls to eliminate it. An obvious alternative to enforced egalitarianism, however, would be to offer those consumers who can expect to receive fewer services from their health plans (whether by their own preference or otherwise) the option of joining a cheaper plan—one whose premiums do not reflect the greater, or more effective, demands of other participants. But the elites who influence health policy have a stake in maintaining egalitarian appearances. Most of them, after all, are high-income employees of large employers and confident of their own ability to manipulate their own health plans and physicians.[24] Their interests help

22. *See* Stuart E. Sheifer et al., *Race and Sex Differences in the Management of Coronary Artery Disease*, 139 AM. HEART J. 848 (2000). This review of earlier studies attributes inequitable treatment of racial minorities to a combination of socioeconomic differences, black patients' greater reluctance to undergo cardiac procedures, and a residue of racial bias.

23. Legal fears may also induce treatment and coverage decisions resulting in higher-income patients receiving a disproportionate share of services at the group's expense, simply because they are perceived as being more likely to assert legal rights. Far from correcting for this problem, the legal system may even frustrate efforts by health plans to resist paying for services demanded by especially assertive patients. For a notable instance in which state regulation and a federal court, giving effect to a litigious patient's exceptional demands, forced an HMO to pay for an expensive treatment that few other plan enrollees could have obtained for the same medical condition, see *Moran v. Rush Prudential HMO, Inc.*, 230 F.3d 959 (7th Cir. 2000) (patient found out-of-state provider of costly, unusual treatment, paid nearly $100,000 for it out of pocket, and eventually got external reviewer to approve coverage).

24. That elite observers support only ostensible egalitarianism is obvious in the objections they raise whenever a managed care plan resists an individual patient seeking arguably desirable services. Critics of managed care virtually never acknowledge that a plan may be merely seeking to ensure that the pool of premiums it administers is allocated in a truly egalitarian manner.

to explain why the political system remains wedded to providing health coverage primarily through regressive tax subsidies,[25] employment-based groups, and highly regulated health plans, all mechanisms through which the expensive tastes of upper middle class consumers are invisibly subsidized by persons with either lower expectations or less ability to command attention to their health problems.

It is not uncommon to discover situations in which the best is the enemy of the good. In this case, however, it is the best and the brightest—a political and policy-making elite—who are the enemies of the common (man's) good. It is especially objectionable for academic experts and self-styled "consumer advocates" claiming to represent the interests of all consumers to support the use of the judicial system and state power to deny fellow citizens alternative kinds of health care that would better meet their respective needs—not only for health care but for other things as well. To satisfy their own needs (including their need to demonstrate their symbolic aspirations for others), the political majority, other special interests, and elite movers and shakers of health policy are content to design things so that lower-income consumers have only a Hobson's choice—either pay the high cost of upper-middle-class medical care or go without any health coverage at all.

III. Strategies for Legitimizing Managed Care Plans and Their Contracts with Consumers

This is not the place to review specific regulatory proposals before Congress and state legislatures. Although many of them seem reasonable enough and not especially onerous on their face, I have just presented reasons to believe we are already well beyond the point where there is much chance that *any* additional prescriptive regulation is cost-justified even for the average consumer. Nevertheless, there is an arguable need for Congress to close some loopholes created by the Employee Retirement Income Security Act of 1974 (ERISA).[26] Not only has ERISA been construed, under some circumstances, to exempt managed care organizations from state law and regulation, but it supplies little consumer protection of its own in the area of health benefits. It is notable for present purposes that the 106th Congress failed to enact a so-called "patient's bill of rights" because a joint conference committee could not reconcile the House- and Senate-passed versions of the long-promised legislation. It is ironic that,

25. Because exclusions from taxable income are more valuable to persons in higher tax brackets, they can be seen as regressive in their effect on tax burdens. The more important observation for present purposes, however, is that, in its present form, the tax subsidy reduces disproportionately the resistance of higher-income persons to spending marginal dollars on health coverage. To the extent that the preferences of these individuals influence employers to choose more costly coverage, lower-income persons are burdened further still. Although these effects are softened by the exclusion's effect of reducing payroll as well as income taxes paid by lower-wage workers, the tax system still appears to add to the pressure on employers to select costlier coverage than lower-income persons would choose for themselves.

26. *See* 29 U.S.C. § 1001 (2000).

despite all the political reasons for expecting Congress to add to HMOs' regulatory burdens in 2000, election-year politics prevented it. Just when many Republicans were concluding that they could enhance their re-election prospects by agreeing on a bill, their Democrat counterparts were becoming increasingly uncompromising, seeing a greater political advantage in running against Republicans on an anti-HMO platform than in finally passing a law. Compromise was also inhibited, no doubt, because both sides could see lucrative fund-raising possibilities in keeping the issue alive for another year. (So much for predicting imminent political outcomes on the basis of simple models like Figure 1.)

In any event, the new Congress, which is even more closely divided than the last one, will again seek a way to deal with the crisis in managed care. Fortunately, promising alternative strategies exist, besides more government prescription and micro-management, for putting the derailed managed care revolution on an appropriate track. Although at the outset of these remarks I observed some of the managed care industry's arguable successes, managed care has generally failed in its mission to offer consumers, even within the limits of existing law and regulation, an appealing variety of arrangements for obtaining reliable health care of appropriate quality at proportionately varying cost. Congress, therefore, faces a serious problem of public policy, not just the political problem I have described. The heart of this policy problem, however, no less than the political one, is the crisis in public confidence in managed care, which has significantly delegitimized even responsible and lawful efforts by health plans to rationalize spending on health services. So the question is: Just how are HMOs and other health plans to achieve the legitimacy they must have to tackle the cost-containment job they are so badly needed to do? Where—to whom and to what institutions—do we look for help in conferring that legitimacy?

My remaining remarks will address the problem of legitimacy in what I hope is a constructive way. My idea is that the crisis of confidence in managed care needs to be addressed, not from the top down by still more prescriptive regulation, but from the grass roots up. Legitimacy is a problem for managed care plans in large part for the reason I have already identified—consumers' feelings of powerlessness in the market for health coverage. As long as consumers lack the power to choose for themselves and to know with some certainty what they are choosing, they will be easily aggrieved even if their HMO complied with all government regulations, operated according to industry standards, had good intentions, and measured up under the experts' criteria. Fortunately, there are several ways in which consumers' confidence in their health plans might be substantially restored. The goal would be simply to empower consumers, giving them enough control and creating enough plan accountability to overcome their current feeling that they are being—or are in danger of being—significantly abused.

In my view, an agenda for legitimizing managed care should include changes in the form of tax subsidies for health coverage so that consumers have

alternatives to employer-purchased benefits.[27] It should also contemplate action in the three additional areas explored in the following paragraphs.

A. Information

Although the role of employers in selecting health plans for their employees is one source of the legitimacy problem, a larger, arguably overriding issue is the poor quality of information available to consumers about the specific goals and methods adopted by individual health plans in their efforts to ensure appropriate spending. Extensive public and private efforts are under way, to be sure, to better inform consumers about what they are buying in health care markets. Mostly these are efforts to provide—through disclosure requirements, accreditation, "report cards," and so forth—better information on the quality of care provided by different health plans and providers, thereby facilitating comparisons and improving the process by which health plans are selected. A policy of encouraging the collection and dissemination of better information about the past performance of plans and providers certainly makes sense.[28] But because information about the quality of health care is extremely hard to collect and interpret, government- or industry-sponsored information strategies alone are unlikely to make the health care marketplace work well enough to overcome the current crisis in confidence and earn HMOs all the legitimacy they need to fight the cost battle effectively in the no-man's land of quality/cost trade-offs.

The paucity of candid information currently available about HMOs is also an issue in some important judicial forums, where some promising additional relief may eventually be obtained. Virtually all of the leading HMO companies are currently the targets of consumer class actions in which the plaintiffs allege that the defendant plan failed to give them what they were promised in the way of high-quality health coverage.[29] A few of these cases have been dismissed because the plaintiffs' lawyers elected to litigate them as all-out substantive attacks on the legality of HMOs and their business methods.[30] Lawyers in the remaining cases, however, may achieve more success by somewhat refocusing their claims. Instead of arguing, or insinuating, that HMOs' standard operating methods are inherently corrupt, anticonsumer, and borderline illegal, lawyers for a plaintiff class can focus their attack more narrowly, not on the defendant's practices themselves but on its failure to tell its subscribers clearly and directly—in its advertising, plan descriptions, and contracts—about both the specific methods it planned to employ and its intention to control spending even at the possible expense of some marginal quality. In fact, HMOs, presumably

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27. *See supra* note 12 and accompanying text.

28. *See* William M. Sage, *Regulating Through Information: Disclosure Laws and American Health Care*, 99 COLUM. L. REV. 1701, 1713-43 (1999).

29. *See* Clark C. Havighurst, *Consumers v. Managed Care: The Class Actions*, HEALTH AFF. (forthcoming July-Aug. 2001).

30. *See, e.g.*, Maio v. Aetna, Inc., 221 F.3d 472 (3d Cir. 2000); Weiss v. Cigna Healthcare, Inc., 972 F. Supp. 748 (S.D.N.Y. 1997).

taking their cues from their marketing departments rather than their lawyers, have uniformly portrayed themselves as benign facilitators of improved health care, carefully obscuring their intentions to restrict physicians' autonomy, to pay physicians in ways that create incentives potentially inimical to patient welfare, and to deny coverage for services they deem unjustified under some (undisclosed) benefit/cost test. Legal attacks on the quality of disclosures made could result in significant improvements in consumers' understanding of the limitations of the particular health coverage they are buying.

Legal challenges to HMOs' misrepresentations, nondisclosure, and systematic fudging on their apparent contractual undertakings may well be cognizable under ERISA, which specifies that employer-sponsored health plans have certain fiduciary duties.[31] In its recent decision in *Pegram v. Herdrich*,[32] the U.S. Supreme Court rejected the use of ERISA as a predicate for putting substantive legal limits on the kinds of incentive arrangements that HMOs may employ with physicians. In a footnote, however, the Court acknowledged that HMOs, as ERISA fiduciaries, may be "obligated to disclose characteristics of the plan . . . if that information affects beneficiaries' material interests."[33] This dictum signifies that misrepresentation claims may succeed where direct legal attacks on HMO methods have failed. It is at least possible, therefore, that the pending consumer class actions will result in prospective remedies increasing the candor and clarity with which individual HMOs and other health plans explain themselves to consumers. Alternatively, of course, Congress might legislate to achieve the same objective. In any event, better disclosure (including more explicit health care contracts and more explicit acknowledgment that health care needs to be, and is to be, rationed under contractual standards) is an essential step in making the market for health care work as well as it can. Indeed, candid disclosure is a *sine qua non* of the consumer consent that alone can confer on HMOs the political and legal legitimacy they obviously need to carry out their vital mission of giving consumers good value for money in health care spending.

B. Suing HMOs for Breach of Contract

The other missing ingredient, besides full disclosure, in HMOs' quest for legitimacy in the eyes of the public and of policymakers is accountability. Accountability can exist in the marketplace if consumers have information about what they can expect from a given health plan and can exit the plan if they have doubts about what is being delivered.[34] But, in these circumstances, a more important form of accountability is the kind enforced by the legal system, to which Americans generally expect to be able to take their serious grievances.

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31. *See* 29 U.S.C. § 1004 (2000).

32. 120 S. Ct. 2143 (2000).

33. *Id.* at 2154 n.8.

34. Exit can create more problems than it solves, however, if plans can induce individual patients to leave the plan as soon as they present a major health problem. Nevertheless, the freedom of group purchasers to take their business elsewhere provides valuable accountability.

The most prominent issue in the debate over the so-called patient's bill of rights has been ERISA's preclusion of personal-injury lawsuits charging plans and their administrators with negligence or bad faith in the administration of coverage. As things now stand, ERISA plans cannot be sued to recover damages for personal injuries caused by erroneous coverage decisions. Current proposals to open HMOs to such suits have been controversial—more so than the added regulatory burdens in the patient's bill of rights, which health plans have little reason to resist if all are impacted equally. Such proposals would either repeal ERISA preemption outright, permitting state remedies to be pursued against employer-sponsored plans, or amend ERISA itself to allow a federal cause of action of a similar, though perhaps more circumscribed, nature.

The arguments for amending ERISA are hard to resist. The idea that a health plan can walk away from the consequences of its erroneous coverage decisions offends many people, including many judges, and their outrage has contributed strongly to the current backlash. And just as a matter of policy, without regard to the political climate, the preemption of normal legal remedies is not easy to defend. Nevertheless, amending ERISA is serious business. Its preemption provisions have been a distinct blessing in sheltering employers and health plans from some burdensome state regulation, thus permitting them to experiment usefully with innovative methods and cost controls. There is also a serious risk in subjecting employers and health plans to second-guessing by juries in personal injury cases triggered by plans' efforts to hold costs down. In the *Pegram* case, Justice Souter rejected one version of the plaintiff's claim partly because, whenever a bad result occurred, "[i]t would be so easy to allege, and to find, an economic influence . . . [that] a factfinder [might] convert an HMO into a guarantor of [a good medical outcome]."[35] Liability fears could easily lead HMOs to practice timid ("defensive") utilization management, resulting in inappropriately higher costs. For these reasons, Congress should seek a way to give health plan enrollees appropriate legal remedies without opening the door to unbridled hindsight and to a large jury award in every case where a bad outcome occurs.

Perhaps the best way to make HMOs appropriately accountable would be to allow personal injury suits for contract breaches, but only by patients who appealed the plan's initial decision unsuccessfully. Under this proposal, a patient who was given a clear and fair opportunity to challenge the original coverage determination and chose not to do so would be precluded from raising the issue with the benefit of hindsight at a later date. Under such a regime, although a patient could not sue if he neglected to pursue an available internal appeal from the initial denial of coverage, he would not be bound by the decision on that appeal, nor would he have to pursue his appeal beyond the first level. So, while patients would have to give the plan a chance to make a final, definitive decision with good information about the case, they would still have substantial remedies for plan errors and breaches of contract. The availability of such remedies would

35. 120 S. Ct. at 2157.

both legitimize active utilization management and improve its quality.[36] Indeed, if health plans and administrators faced liability on these terms, they would have strong incentives to pursue contractually authorized rationing of financing in an open and honest way, using procedures that enhance the accuracy and consistency of contract administration.[37]

A major challenge in making HMOs reasonably and appropriately accountable for their coverage decisions, without introducing even more costly prescriptive regulation, is to ensure that the standards to which they are held on appeal and in court are contractual, not regulatory, ones. The Norwood-Dingell Bill, one of the leading compromise versions of the patient's bill of rights in the 106th Congress, would have treated many plan decisions as so-called "medically reviewable determinations" and subjected them to mandatory review by independent medical practitioners.[38] Although the bill was less than clear, it seemed to contemplate that most coverage determinations would be deemed "medically reviewable" and would be reviewed for consistency, not with the plan's contract with its subscribers, but with professional standards. Even though such standards are routinely invoked by the legal system for prescriptive regulatory purposes in malpractice cases as well as in coverage disputes, they are apt to be very costly. Moreover, in many cases they are far from uniform, varying substantially from place to place and practice to practice. In addition to neglecting benefit/cost trade-offs, such standards have never been examined by legislators to determine whether they constitute sound public policy appropriately enforced in all cases in coercive, regulatory ways. They should therefore not be made mandatory unless the health plan affirmatively embraces them as the standards by which it wishes to be bound. If Congress were to legislate in such a way as to make professional standards the norms applicable to all HMO

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36. Regulatory oversight and remedies for breach of the duty of good faith and fair dealing would also be essential to protect against a plan's pursuing policies resulting in too many initial denials' being reversed on initial appeal. Without such oversight and remedies, the suggested regime would tempt a plan not to be consistent and evenhanded in administering its benefits but instead to adopt restrictive policies in the first instance, providing generous treatment only to "squeaky wheels" who, having appealed an initial denial, would be in a position to sue at a later date in the event of a bad result. Though not widely recognized as such, such discrimination in favor of articulate, assertive, and potentially litigious patients is already a problem, perhaps of scandalous propositions, in organized health plans. *See supra* notes 21-25 and accompanying text.

37. Health plans could also be protected against excessive exposure to liability based on hindsight by preserving the doctrine of *Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101 (1989). In that case, the Supreme Court held, under ERISA, that health plan contracts could give plan administrators substantial discretion in administering the plan, having their interpretations of contract terms overturned by courts only if they were arbitrary or capricious. Thus, unavoidable contractual ambiguities could not be construed against the plan so long as its interpretations were not unreasonable and were applied consistently in similar cases. For court-suggested language for clearly disclosing (and thus legitimizing) the existence of such discretion, see *Herzberger v. Standard Insurance Co.*, 205 F.3d 327, 330 (7th Cir. 2000).

38. H.R. 5628, 106th Cong., 2d Sess. (2000).

coverage determinations (other than those made pursuant to purely categorical exclusions), it would have effectively reinstated the old professional paradigm of medical care, which is precisely the problem that managed care was designed to solve by introducing new opportunities for consumer choice. It was fortunate that political gridlock defeated the Norwood-Dingell Bill and similar legislation in the 106th Congress, leaving the possibility that the nation will ultimately adopt a less prescriptive approach to resolving the crisis in managed care.

C. *Vicarious Liability for Provider Torts*

There is one more form of legal accountability—one that, unfortunately, is currently found only on academic policy agendas[39]—that is at least equally important if HMOs are to achieve enough legitimacy in the public eye to perform their cost-containment tasks effectively. At this stage in the managed care revolution, corporate health plans have assumed extensive responsibility for the cost of care without accepting more than nominal responsibility for its quality. Only a moment's reflection should suggest that this situation is unlikely to be satisfactory as a matter of public policy. Nor can the managed care industry's public relations problems be overcome as long as it prevails. Before health plans can reasonably expect to be tolerated by the public as administrators of cost controls, they must bear some substantial legal responsibility whenever the quality of care provided under their auspices falls below appropriate standards—regulatory or contractual, as the case may be.

The current crisis of confidence in the managed care industry results in large part because, despite what individual health plans may say or imply in their advertising, they have accepted little real responsibility for the quality of care. Virtually all health plans include in their contracts a disclaimer of all legal responsibility for the care that their physicians provide, saying to enrollees in effect: "Don't sue us. Sue your doctor." In this respect, health plans have found it convenient to adhere to the convention that physicians alone are accountable to patients for the quality of care. The effect of adhering to this principle,

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39. For expositions of the concept, which have also been marketed under the name "enterprise liability," see Clark C. Havighurst, *Vicarious Liability: Relocating Responsibility for the Quality of Medical Care*, 26 AM. J.L. & MED. 7 (2000) [hereinafter Havighurst, *Vicarious Liability*]; Clark C. Havighurst, *Making Health Plans Accountable for the Quality of Care*, 31 GA. L. REV. 587 (1997); William M. Sage, *Enterprise Liability and the Emerging Managed Health Care System*, 60 LAW & CONTEMP. PROBS. 159 (1997); William M. Sage et al., *Enterprise Liability for Medical Malpractice and Health Care Quality Improvement*, 20 AM. J.L. & MED. 1, 1-2 (1994) (joining a "chorus of voices that proposes to refocus liability for medical malpractice on the organizations that will increasingly bear practical responsibility for providing health care services"); David M. Studdert & Troyen A. Brennan, *Deterrence in a Divided World: Emerging Problems for Malpractice Law in an Era of Managed Care*, 15 BEHAV. SCI. & L. 21, 48 (1997) (concluding that enterprise liability, though "no panacea for achieving sharp deterrence in the malpractice sphere[,] . . . [is] capable of correcting some aspects of the incompatibility between malpractice law and new organizational models").

however, is to cut health plans entirely out of the picture at precisely the point where quality comes into view. Good policy, however, would require that liability fall on the party in the best position to compare the costs and benefits of measures to prevent injuries and to take, or induce others to take, the indicated precautions.[40] This criterion for policy points strongly to vicarious liability. If this principle were clearly fixed in law, it would also ameliorate HMOs' public relations problem, adding substance to their claim that they are dedicated to serving consumer interests.

For these reasons, a crucial step in restoring the legitimacy of the managed care industry—and also in improving its performance—would be to establish as a "default rule" (operating in the absence of an alternative contractual arrangement) the principle that a health plan is vicariously, and exclusively, liable for medical malpractice and other torts committed by the health care providers it procures to treat its enrollees. In time, courts would probably impose something like vicarious liability on HMOs as a matter of law, just as they have gradually moved toward making hospitals liable for the torts of emergency room physicians.[41] But the need to reassign responsibility clearly and decisively is great enough in my mind that I have proposed legislation to make a clear break with the old professional paradigm.[42] Although my proposed legislation would make vicarious liability the default rule, it would also permit patients and physicians to maintain traditional doctor-patient relationships under certain limited conditions. It also contemplates that many plans would routinely pass liability on to subcontractors, which would in most cases not only bear financial risks for the care to be delivered but also be better positioned to monitor and

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40. *See* GUIDO CALABRESI, THE COSTS OF ACCIDENTS: A LEGAL AND ECONOMIC ANALYSIS 135-73 (1970) (classic study recommending general deterrence approach to accident liability, including assignment of liability to induce appropriate attention to quality, targeting in particular parties who, given transaction costs, are apt to be in the best position to control quality or influence others to do so).

41. *E.g.*, Simmons v. Tuomey Reg'l Med. Ctr., 533 S.E.2d 312 (S.C. 2000) (holding hospital has nondelegable duty to render competent service to patients in emergency room, if patient sought care from hospital, not individual physician). *See also* Petrovich v. Share Health Plan, Inc., 719 N.E.2d 756, 770–75 (Ill. 1999) (denying summary judgment to HMO on vicarious liability claim because its various ways of influencing physicians might be found to amount to sufficient control to justify finding implied agency, despite independent contractor relationship). Many observers will be inclined to believe that common law courts, in holdings like that in *Petrovich*, which make it relatively easy for a plaintiff to establish an HMO's vicarious liability, are making HMOs appropriately accountable and that legislation of the kind suggested here is unnecessary. Yet the *Petrovich* decision clearly imposes vicarious liability only as a penalty for the HMO's interfering with medical decisions in the interest of cost containment and not as an inducement to encourage all plans to take a more active and constructive role in improving quality. *See id.* at 763-64, 770-76. Perversely, the *Petrovich* signal to health plans is to take less, not more, responsibility for the quality and cost of care.

42. *See* Havighurst, *Vicarious Liability*, *supra* note 39, at 29 (setting forth proposed statutory language establishing vicarious liability).

improve quality than was the plan itself.

The argument for legislation making health plans legally accountable, in the first instance, for the quality of care delivered to patients rests on the logic and likely beneficial consequences of assigning responsibility for both cost and quality to the same entity. Until health plans and their subcontractors are forced—either by the market or by the legal system—to be substantially accountable for the quality of care, the managed care revolution will remain unfinished, and health plans will continue to lack the kind of close integration of financing and delivery that was originally expected to be the hallmark of managed care. To be sure, few of today's health plans are ready as a practical matter to assume managerial responsibility for the quality of care, and a good deal of restructuring would be required to put them in a position to exercise meaningful influence or control. Nevertheless, making health plans presumptively liable whenever their selected providers breach legal duties to their patients would induce desirable moves toward finally realizing the efficiency potential of managed care and allowing health plans to directly address concerns that have recently been voiced about the frequency of medical errors and the overall quality of care.[43] A definitive shift to vicarious liability would also eliminate much of the current destructive tension between health plans and physicians. Indeed, finally bringing HMOs' and physicians' obligations to patients into some alignment would weaken one of the main subversive impulses fueling the current backlash against managed care and impeding realization of its immense promise.

CONCLUSION

In conclusion, then, I suggest responding to the backlash against managed care by focusing attention, not on devising new forms of command-and-control regulation, but on finding ways to confer political and legal legitimacy on organized health plans. The key to legitimacy is accountability, both in the marketplace and in the courts. Accountability has three essential elements: first, fuller and more candid disclosure of the goals, intentions, and methods of individual health plans; second, limited, but substantial, legal accountability of HMOs for errors or bad faith in the administration of health coverage; and third, presumptive vicarious liability of HMOs for the negligence and other torts of their various subcontractors. Once health plans provide good notice of what they are undertaking to do for consumers and can be held accountable in court when they fail to deliver on those undertakings, the market for health care financing and health services will begin to stabilize, enabling the managed care revolution to proceed in accordance with its democratic premise.

Unfortunately, the political fight over the patient's bill of rights has been fraught with peril for the generally enlightened policy of leaving to consumers and their selected agents the fundamental choice about how much and what kinds

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43. *See, e.g.*, INSTITUTE OF MEDICINE, TO ERR IS HUMAN: BUILDING A SAFER HEALTH SYSTEM (Linda T. Kohn et al. eds., 1999).

of health care individual patients should receive. Instead of subjecting HMOs to more regulation, government should create conditions under which trade-offs between quality and costs can, to the extent possible, be accurately reflected in consumers' purchasing decisions and memorialized in private contracts rather than prescribed in law. To be sure, converting health care into a true consumer good that people purchase according to their preferences and their resources (including substantial public subsidies) is a immensely difficult undertaking, and it is currently encountering intense resistance from professional interests, political leaders, and legal institutions, which systematically refuse to step aside and yield power to consumers and their private agents in the marketplace. But it is still open for legislatures and courts to reject micro-managing of managed care plans and to focus instead on two things: empowering consumers with information that will enable them to know with reasonable certainty what they can expect from various health plans, and giving them well crafted legal rights to enforce those expectations against the health plans they choose.

Today's backlash against managed care is fully warranted by the failure of health plans to market themselves honestly and to accept appropriate legal responsibility both for honoring their contracts and for the quality of services provided under their auspices. This crisis in public confidence is providing an extremely interesting test of our political and legal systems. It remains to be seen whether those institutions can find ways to respond to legitimate public concerns, not by further undermining the democratic marketplace, but by devolving more authority to consumers, assisting them in finding trustworthy agents, and enforcing the obligations of those agents when they breach their contracts and their trust.

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NOTES

IS *HAMILTON V. ACCU-TEK* A GOOD PREDICTOR OF WHAT THE FUTURE HOLDS FOR GUN MANUFACTURERS?

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INTRODUCTION

> "We are all very upset. We are starting to fight. We cannot reach a decision. We are emotionally drained and some of us feel physically ill!! Please, please give us more direction!!"[1]

These were the first pleas from the jury to district court Judge Jack Weinstein in February 1999, after four days of deliberations in a novel products liability case. The judge responded: "Everybody has invested, including yourselves, too much time in this case to allow you to throw up your hands prematurely."[2] Although exhausted and reluctant, the jurors resumed deliberations and reached a consensus two days later. The surprising verdict made legal history while sparking fierce debate in the world of products liability.

On February 11, 1999, fifteen gun manufacturers were found liable for three gunshot fatalities and one injury on the theory of negligent distribution in the case of *Hamilton v. Accu-tek*.[3] This verdict marks the first time the gun industry has been held collectively liable[4] for the criminal uses of its products. Supporters of the lawsuit hailed the decision as a breakthrough in a country where guns often symbolize freedom, independence, and justice.[5] Although the significance of the judgment was dampened by the fact that just three of the companies were

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1. Vanessa O'Connell & Paul M. Barrett, *Open Season: How a Jury Placed the Firearms Industry on the Legal Defensive*, WALL ST. J., Feb. 16, 1999, at A1 (quoting a note from the jury to the judge).

2. *Id.*

3. No. 95 Civ. 0049 (E.D.N.Y. 1999).

4. This theory of liability allows plaintiffs to hold all potentially responsible defendants liable in the interests of justice since plaintiffs would have no other way of obtaining relief. *See* Summers v. Tice, 199 P.2d 1, 4 (Cal. 1948).

5. *See* David Kairys, *Legal Claims of Cities Against the Manufacturers of Handguns*, 71 TEMP. L. REV. 1, 3 (1998).

assessed damages for only one of the seven victims,[6] this did not prevent supporters from predicting a string of successes in the courtroom. However, the highly controversial nature of the verdict and corresponding theories of liability will prevent subsequent plaintiffs from achieving similar results, as many other jurisdictions are still unpersuaded by the plaintiffs' legal arguments and uncomfortable with the public policy issues tied to resolving society's concerns about gun violence in court.

The *Hamilton* decision was also welcomed by cities around the country, totaling almost thirty,[7] who have sued gun manufacturers on negligence and public nuisance theories for the reimbursement of millions of dollars in police and medical expenses resulting from gun-related crimes.[8] In an attempt to repeat the success of some of the claims against the tobacco industry, many cities have modeled their suits after those of the state attorneys general involved in the tobacco litigation. However, there was no organization analogous to the National Rifle Association (NRA) with a stake in the tobacco litigation, and it has proved to be a resourceful organization for gun manufacturers now facing a fight. In response to the cities' claims, the NRA retaliated on behalf of the industry by introducing and passing legislation in several states that prohibits municipalities from filing suits against gun manufacturers and dealers.[9] Although most of the city suits previously filed were unaffected by this legislation, the cities that were preempted are already fighting the new laws in court.[10] As the litigation continues, the cities hope that their suits will at least result in a settlement, but the prospects for large financial concessions are unlikely when considering the intervening power of the NRA and the stark differences between the tobacco and gun industries. However, the cities might be able to strike a deal at the bargaining table by using their legal leverage to gain restrictions on industry practices, which could include heightened safety measures and tighter controls on distribution channels. Nevertheless, the new Bush administration, clearly supportive of the NRA, could use its power to minimize the cities' chances of gaining a favorable agreement from the gun industry.

This Note addresses the meaning of the *Hamilton* verdict while illustrating

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6. *See* Hamilton v. Accu-tek, 62 F. Supp. 2d 802, 808 (E.D.N.Y. 1999).

7. A partial list of the cities who have already filed includes: New Orleans, Chicago, Atlanta, Miami-Dade County, Fla., Bridgeport, Cleveland, Detroit, Wayne County, Mich., Cincinnati, Hamilton County, Oh., St. Louis, Los Angeles, San Francisco, Newark, and Boston. *See* Timothy A. Bumann, *Gun Control Through Retailer Litigation*, BRIEF, Fall 1999, at 21, 27.

8. *See* Paul M. Barrett, *Chicago Sues Gun Makers in Battle's Second Shot*, WALL ST. J., Nov. 13, 1998, at A3.

9. *See* Lisa Gelhaus, *Brooklyn Jury Adds Momentum to Antigun Litigation*, TRIAL, Apr. 1999, at 96, 98. Georgia just enacted an NRA-backed bill, O.C.G.A. § 16-11-184, that may preempt the suit previously filed by the city of Atlanta, while already prohibiting other Georgia cities from filing similar suits. *See id.* at 98. The NRA has also planned legislation for numerous other states. *See id.*

10. *See* David Firestone, *Gun Lobby Begins Concerted Attacks on Cities' Lawsuits*, N.Y. TIMES, Feb. 9, 1999, at A1.

why courtroom battles against gun manufacturers will find little success. Part I introduces the initiative to pursue legal sanctions against gun manufacturers. Next, Part II addresses the unsuccessful theories previously used against gun makers and the more recent theories of negligent marketing and distribution. Part III then discusses the most influential case prior to *Hamilton*, and Part IV explains the details of the *Hamilton* case. Finally, Part V surveys the strengths and weaknesses of the suits filed by the cities, and Part VI concludes with an analysis of the future of the gun litigation.

I. THE INITIATIVE TO PURSUE LEGAL SANCTIONS AGAINST GUN MANUFACTURERS

The motive for pursuing legal relief from the gun industry has escalated with the notoriety of recent shootings and the success of imposing liability on other powerful industries like Big Tobacco. However, a little background on the presence of guns in the United States provides additional insight into the conflict and the motivation for the litigation.

Citizens in the United States own approximately 192 million guns[11] and in 1997, firearms killed more than 32,400 people.[12] The United States also holds the unenviable title of leading the world in the number of people who die or are injured by handguns every year, which is approximately fifty times the amount in every other industrialized country.[13] Furthermore, gun deaths disproportionately affect young people, illustrated by the fact that gun deaths peak between the ages of 15 and 24.[14] In some states, such as New York, California, and Texas, gunshot fatalities have surpassed car accidents as the leading cause of unnatural death.[15] Aside from the toll of human lives, the cost of providing medical care for gun-related injuries in 1995 was estimated at $4 billion,[16] which does not take into consideration police and emergency services, disability benefits, security costs at schools and public buildings, and prison costs.[17] As a result of these circumstances, many crime victims and their families have renewed their interest in searching for an alternative source of compensation for their injuries by using the tort system. In addition, almost thirty cities have also joined the battle, filing lawsuits against the gun

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11. *See* Susan DeFrancesco, *Children and Guns*, 19 PACE L. REV. 275, 276 (1999).

12. *See* Brian J. Siebel, *City Lawsuits Against the Gun Industry: A Roadmap for Reforming Gun Industry Misconduct*, 18 ST. LOUIS U. PUB. L. REV. 247, 250 (1999).

13. *See* Kairys, *supra* note 5, at 2.

14. *See* DeFrancesco, *supra* note 11, at 276.

15. *See* Timothy D. Lytton, *Negligent Marketing:* Halberstam v. Daniel *and the Uncertain Future of Negligent Marketing Claims Against Firearms Manufacturers*, 64 BROOK. L. REV. 681, 681 (1998).

16. *See* DeFrancesco, *supra* note 11, at 277.

17. *See* Siebel, *supra* note 12, at 251. Chicago has estimated that its costs of gun violence exceed $850 million every few years. *See* Amended Complaint for Plaintiff at 76-77, Chicago v. Beretta U.S.A. Corp., No. 98-CH-015596 (Cook County Cir. Ct. 1998).

manufacturers in order to recoup the public costs of gun violence.[18]

Anti-gun groups and potential plaintiffs have also set their sights on the judicial system because guns are one of the consumer products most resistant to federal regulation. Congress has excluded guns and ammunition from the jurisdiction of the Consumer Products Safety Commission, while also prohibiting certain public health research on guns by the Centers for Disease Control.[19] Furthermore, under the Consumer Product Safety Act, Congress enacted a rule that prevents the Commission from taking any action that might restrict the availability of firearms to the consumer.[20] In fact, the only federal organization with any regulatory power over the industry is the Bureau of Alcohol, Tobacco, and Firearms, an agency whose power is limited to issuing federal firearms licenses, collecting excise taxes, and tracing stolen guns.[21] In contrast, public debates surrounding the dangers of tobacco, drugs, and asbestos have scrutinized the activities of manufacturers and distributors, while the gun debate has rarely focused on the responsibilities of these parties.[22]

The immunity to regulation that the gun industry has received could be a result of the status that guns have enjoyed in our history, culture, and the Constitution. Since our country was founded through armed revolution, guns have often symbolized freedom, independence, and justice.[23] The media has also contributed to this symbolism by capitalizing on the theme that well-armed people stand for heroism and truth and will triumph in the end.[24] Today, gun owners and pro-gun groups ferociously defend what they view as a fundamental right in the Second Amendment "of the people to keep and bear arms. . . ."[25]

In 1999, gun sales exploded across the country, which may have increased the awareness of gun violence and further fueled the resolve of plaintiffs and cities. One entrepreneur in California predicts a fifty percent increase in sales over 1998, while a retailer in Minnesota has experienced a 112% rise in sales

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18. *See* Bumann, *supra* note 7, at 27; *see also* Frank J. Vandall, *O.K. Corral II: Policy Issues in Municipal Suits Against Gun Manufacturers*, 44 VILL. L. REV. 547, 553 (1999) (explaining that in economic terms the cities are asking the industry to internalize the costs of gun violence, which already occurs in the steel industry where manufacturers must pay the cost of air and water pollution).

19. *See* Kairys, *supra* note 5, at 3.

20. *See* Ted Copetas, *Handguns Without Child Safety Devices—Defective in Design*, 16 J.L. & COM. 171, 174 (1996).

21. *See* Fox Butterfield, *Bill Would Subject Guns to Federal Safety Controls*, N.Y. TIMES, Mar. 3, 1999, at A10.

22. *See* Kairys, *supra* note 5, at 3.

23. *See id.*

24. *See id.* The status and support of guns varies from region to region across the country, but the "Wild West" may be more resistant to suits against the gun industry as one lawyer from the area comments, "[i]n the West, a gun rack and an open can of beer in the truck are both considered sacred, and we're not going to try and change these cowboys." Douglas McCollam, *Long Shot*, AM. LAW., June 1999, at 86.

25. U.S. CONST. amend. II.

from the first five months of the year, compared with 1998.[26] There are several reasons for such a rise in sales. First, some gun makers sought out new markets by focusing on women and youth after they experienced stagnant sales in the early 1990s. In 1992, the magazine of the National Shooting Sports Foundation carried a column by industry celebrity Grits Gresham, in which he said: "There's a way to help insure that new faces and pocketbooks will continue to patronize your business: Use the schools . . . . [I]t's time to make your pitch for young minds, as well as for the adult ones."[27] Another reason for the increase in sales is the fear of new regulations and stiffer gun control laws, which has encouraged a stampede of first-time buyers.[28] Nevertheless, as plaintiffs continue their battle against guns, the number of legal theories that have consistently failed plaintiffs in the past presents quite an obstacle.

II. UNSUCCESSFUL THEORIES OF LIABILITY

While plaintiffs have employed numerous product liability theories to pursue relief against gun manufacturers, the claims have consistently fallen short due to the presence of a criminal act by an intervening shooter. The majority of the theories used have been variations of strict liability or negligence concepts.[29]

Strict liability[30] once held high hopes for gun plaintiffs, but has now been almost entirely discarded.[31] In fact, one professor has stated,

> Regrettably, rumors of the death of strict liability as a viable theory for suing handgun manufacturers have not been greatly exaggerated. Courts have rejected strict liability. Legislatures have rejected it. Influential commentators have rejected it.
>
> . . . However, reality dictates that, at least for the present, victims of gun violence and their lawyers should refocus their sights on the more prosaic liability theory of common law negligence.[32]

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26. *See* Paul M. Barrett, *Boom Times: Industry Under Siege, Threats of Regulation*, WALL ST. J., June 8, 1999, at A1.

27. Kairys, *supra* note 5, at 11.

28. *See* Barrett, *supra* note 26, at A1.

29. *See* Andrew Jay McClurg, *The Tortious Marketing of Handguns: Strict Liability Is Dead, Long Live Negligence*, 19 SETON HALL LEGIS. J. 777 (1995).

30. Strict liability is defined as liability regardless of fault; therefore an actor whose conduct proximately causes harm to another is liable even if the action was reasonable or if extraordinary care was used. *See* JAMES A. HENDERSON, JR. ET AL., THE TORTS PROCESS 185 (4th ed. 1994).

Herbstman v. Eastman Kodak Co., 342 A.2d 181, 184 (1975), further explains the concept of strict liability by stating the tort is founded on the idea that when a manufacturer presents his products to society for sale, he represents they are suitable for their intended use. Therefore, to use this doctrine the plaintiff must prove that the product was defective when it was placed in the stream of commerce. *See id.*

31. *See* McClurg, *supra* note 29, at 777.

32. *Id.* at 777-78.

Plaintiffs suing gun manufacturers typically tried one of two strict liability theories.[33] The first prospect, a risk-utility balancing approach, alleged that guns are unreasonably dangerous because their risk outweighs their social utility.[34] The second argument proposed that the production or sale of handguns constituted an abnormally dangerous activity under the Restatement (Second) of Torts.[35] However, both arguments were consistently unsuccessful for both legal and public policy reasons.

First, risk-utility analysis is normally used in litigation involving the existence of a defect in the design of a product.[36] This balancing approach is helpful in judging a product that was manufactured as intended because the usual means for determining defectiveness, like the use of a standard, are unavailable.[37] The risk component of the defective design analysis addresses the probability and the severity of the harm possible to the consumer, or others who may be foreseeably harmed,[38] while the utility factor considers the value of the design to the consumer and society at large and whether there is a feasible alternative.[39] The obstacle for plaintiffs using this type of liability against gun manufacturers has been a refusal by the courts to extend the analysis to dangerous products that cannot be made safer.[40] Consequently, plaintiffs have faced the burden that guns

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33. *See id.* at 779.

34. *See id.*

35. *See id.* The Restatement (Second) of Torts states that strict liability is provided for "[o]ne who carries on an abnormally dangerous activity . . . for harm to the person, land or chattels of another resulting from the activity, although he has exercised the utmost care to prevent the harm." RESTATEMENT (SECOND) OF TORTS § 519-20 (1977).

36. *See* McClurg, *supra* note 29, at 779.

37. *See id.* at 779-80. Conversely, in cases surrounding manufacturing flaws, there is a standard for evaluating the product, which includes all the other products of the manufacturer that did not malfunction. *See id.* at 780. For example, it is logical to conclude that an exploding soft drink bottle is defective because it can be compared to countless other bottles that did not explode. However, alleged defects that result from conscious design choices, such as handguns, are extremely hard to evaluate since there is no external standard present for comparison. *See id.* Therefore, the only solution is to balance the risk of the product design against its utility. *See id.*

38. *See* Carl T. Bogus, *Pistols, Politics, and Products Liability*, 59 U. CIN. L. REV. 1103, 1109 (1991).

39. *See* McClurg, *supra* note 29, at 780. In examining whether an alternative feasible design exists, the alternative: (1) must be safer than the challenged design; (2) must be technologically feasible; (3) must be economically feasible; (4) must not impair the usefulness of the product for its intended purpose; and (5) must not create other risks equal to or greater than the risk which manifested itself in injury to the plaintiff. *See id.*

40. *See id.* at 781. In general, courts have accepted that guns cannot be made safer without unduly destroying their utility. An example of a court rejecting liability based on a risk-utility analysis is the case of *Patterson v. Gesellschaft*, 608 F. Supp. 1206 (N.D. Tex. 1985), where the court held that a robbery victim had no cause of action against gun manufacturers in Texas. *See id.* at 1216. The plaintiff sought recovery under a risk-utility analysis and defective distribution. *See*

are performing as expected when they are used to injure or kill humans.

The second theory, that the manufacture or sale of guns constitutes an abnormally dangerous activity under sections 519-20 of the Restatement (Second) of Torts, has also been unsuccessful.[41] The rationale of the theory supposes that these activities present such unusual risks of danger that the responsible parties, like gun manufacturers, should pay the damages inflicted on society.[42] However, courts have rejected plaintiffs' arguments under this theory and stated that in contrast to the manufacture or sale of a gun, only activities that are dangerous "in and of themselves and that can directly cause harm" are encompassed by the Restatement.[43] Therefore, theories of strict liability have continued to fail because the legal sale of a non-defective product has never been considered an abnormally dangerous activity. Additionally, courts have consistently ruled that a gun does not become defective when an individual uses it to commit a crime.[44]

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id. at 1208. The court dismissed the argument quoting:

> Virtually any product can be put to an illegal use: an automobile can be used in order to make a getaway from a bank robbery, or a ship in order to smuggle drugs, yet no one would suggest that those products were not performing their intended function of transportation. The argument that a jury should be permitted to subject a product to risk/utility scrutiny merely because it is often used illegally has no logical limit: the manufacturer of any product that is frequently put to illegal use could be called into court to defend his product.

Id. at 1213 (quoting Windle Turley, *Manufacturers' and Suppliers' Liability to Handgun Victims*, 10 N. KY. L. REV. 41, 60-61 (1982) (citation omitted)).

Only one case has ever held a gun manufacturer strictly liable for a non-defective product, but the court's decision was quickly vacated by the state legislature. In *Kelley v. R.G. Industries, Inc.*, 497 A.2d 1143, 1144 (Md. 1985), the plaintiff was a store clerk who was shot with a Saturday Night Special during a robbery. The court described such guns as "particularly attractive for criminal use and virtually useless for [] legitimate purposes" and held that strict liability could be imposed on these manufacturers. *Id.* at 1154. The reasoning of the decision included a risk/utility analysis and the court concluded that these guns present an unusually high risk of being involved in criminal activities while having few other uses. *See id.* at 1161-62. Consequently, the Maryland legislature overruled the case by passing legislation that prohibited strict liability for gun manufacturers. *See* McClurg, *supra* note 29, at 784.

41. *See* McClurg, *supra* note 29, at 788; *see also* RESTATEMENT (SECOND) OF TORTS § 520 (1977).

42. *See* McClurg, *supra* note 29, at 788; *see also* RESTATEMENT (SECOND) OF TORTS § 519, cmt. d (1977).

43. McClurg, *supra* note 29, at 790. Other courts have rejected the abnormally dangerous activities doctrine by concentrating on the doctrine's connection to activities related to land which may threaten neighboring owners. *See id.* Some courts have found that the manufacture and marketing of guns does not meet the requirement that the activity not be a matter of common usage. *See id.* at 791.

44. *See* Timothy A. Bumann, *A Products Liability Response to Gun Control Litigation*, 19 SETON HALL LEGIS. J. 715, 724 (1995).

Claims of negligence have also been unsuccessful for plaintiffs suing gun makers. Negligence involves the creation of an unreasonable risk of harm to another—a risk of harm greater than what society is willing to accept in light of the benefits of the activity.[45] The general standard is one of reasonable care under the circumstances,[46] but plaintiffs have encountered problems in defining and asserting a duty of care on the part of the manufacturer that courts will accept.[47] One way to invoke a duty uses the concept of foreseeability, which may include the foreseeability of the plaintiff or of the harmful circumstances.[48] In gun litigation, establishing the foreseeability of an individual plaintiff might be shown through the mass marketing of guns to the general population, while the foreseeability of harmful consequences might be illustrated using the statistical evidence surrounding the human and financial cost of guns.[49] Other factors beyond foreseeability have also been used to assert a duty, including the moral culpability of the defendant, the morality, fairness, and justice of imposing a duty, the causal connection between the conduct and the harm, the magnitude of the risk, the utility of the conduct, and the potential value of deterrence.[50]

However, after finding little success under strict liability and general negligence concepts, plaintiffs have recently started to assert theories of negligent marketing and distribution.[51] Within these theories, the focus is on the collective liability of a large group of manufacturers rather than on the marketing of a single weapon.[52] The entire group could potentially be held responsible for the allegedly lax marketing and distribution methods of the industry. Therefore, not only can the claims be broader under collective liability, but they can also be easier to assert because of the technical difference between a strict liability claim

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45. *See* HENDERSON ET AL., *supra* note 30, at 185.

46. *See id.* at 201.

47. Professor McClurg has applied this problem to gun litigation and explained:

> Faced with a novel negligence claim that he or she does not favor, a judge need only incant the magic words "no duty" and the case is over. Thus, to have any chance of successfully battling the handgun industry in the negligence arena, plaintiffs need to go to court well-prepared to fight and win the duty contest.

McClurg, *supra* note 29, at 796.

48. *See id.* at 796-97.

49. *See id.* at 797.

50. *See id.* at 797-98; *see also* William L. Prosser, *Palsgraf Revisited*, 52 MICH. L. REV. 1, 15 (1953). "In the decision whether or not there is a duty, many factors interplay: the hand of history, our ideals of morals and justice, the convenience of administration of the rule, and our social ideas as to where the loss should fall." *Id.*

51. Negligent marketing claims attempt to show that the marketing of guns, followed by the harm that can be inflicted by the guns, presents substantial risks that should be termed unreasonable in the realm of negligence law. *See* McClurg, *supra* note 29, at 799. However, these claims are still developing. *See id.*

52. *See* Anthony Gallia, Comment, *"Your Weapons, You Will Not Need Them," Comment on the Supreme Court's Sixty-Year Silence on the Right to Keep and Bear Arms*, 33 AKRON L. REV. 131, 157 (1999).

and a negligence claim.[53] This difference lies in the fact that the negligence claim focuses on the conduct of the manufacturer, while strict liability narrowly focuses on the condition of the product.[54]

Three theories have emerged from negligent marketing and distribution claims. The first theory asserts that the manufacturer acts negligently by marketing a weapon that presents an unusually high risk of harm while providing only minor utility for legitimate purposes. This theory is similar to the risk-utility analysis discussed under strict liability.[55] However, plaintiffs can utilize one advantage by asserting a negligence claim. Specifically, plaintiffs need only show a flaw in the defendant's *conduct*, not in the product itself.[56] Therefore, the duty present in this theory would be breached when a manufacturer implements a marketing plan designed to intentionally target criminal buyers.[57]

The second theory alleges that manufacturers implement marketing strategies that intentionally, recklessly, or negligently target criminal consumers.[58] Similarly, the third theory claims that manufacturers have failed to take reasonable steps during marketing to minimize the risk that their products will be purchased by consumers likely to misuse them.[59]

In response to allegations of negligent marketing and distribution, defendants have countered with issues of causation, asserting that an intervening criminal act[60] relieves them of any liability.[61] The most promising defense occurs when

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53. *See* McClurg, *supra* note 29, at 800.

54. *See id.* Although the difference may not be tremendous, the distinction might give those judges who support tort cases, "a hook on which to hang their legal hats," especially when the increased media attention given to gun tragedies may also have convinced some judges to reconsider the policy issues that were rejected along with strict liability. *Id.* at 802.

55. *See id.* at 799.

56. *See id.* at 801. For example, to find for a plaintiff the court would rule that the product was acceptable, but there was something wrong with the manner in which the product was sold or marketed. *See id.*

57. *See id.* at 806. Negligence law requires that persons act with reasonable care to avoid foreseeable risks of harm to others, which could also include protecting against risks of criminal attack. *See id.* Some courts have imposed liability on firearms retailers who failed to exercise reasonable care in purchase transactions that created foreseeable risks of criminal attack. *See id.* at 806; *see also* Cullum & Boren-McCain Mall, Inc. v. Peacock, 592 S.W.2d 442, 449 (Ark. 1980) (holding defendant liable for sale of gun to customer who requested a product that would make a "big hole" in a person); West v. Mache of Cochran, Inc., 370 S.E.2d 169, 174 (Ga. Ct. App. 1988) (holding defendant responsible for sale of semi-automatic rifle to former mental patient); Bernethy v. Walt Failor's, Inc., 653 P.2d 280, 285 (Wash. 1982) (holding defendant liable for furnishing a rifle to an intoxicated person).

58. *See* McClurg, *supra* note 29, at 806.

59. *See id.*

60. An act which follows any conduct of the defendant but occurs before the injury is an intervening act, and the problem that arises is whether the defendant can be held liable for an injury to which he may have made a contribution, but was not entirely responsible. *See* W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS § 30, at 301 (5th ed. 1984). The question

the crime is remote in time and place from the purchase of the gun because a reasonably close causal connection, or proximate cause, is required to link the conduct and the resulting injury.[62] However, absent facts placing a defendant on notice of the probability of a crime being committed with the product, there is no foreseeability as a matter of law.[63] Thus, the true obstacle in establishing causation is overcoming an intervening act because criminal conduct will generally interrupt a chain of causation.[64] Therefore, when a plaintiff is injured as the result of the intentional, criminal act of another, it is highly unlikely the plaintiff will be able to demonstrate the necessary proximate causal connection, which would allow the manufacturer's defense to prevail in most jurisdictions.[65]

Within any of these theories, the rationale supporting liability is the concept that victims of gun violence should be allowed to recover from manufacturers because they are most responsible for the loss and should therefore have the duty of repair.[66] Consequently, plaintiffs hope that realistic threats of liability will force the industry to improve the design, sale, and distribution processes of their products to avoid paying legal fees and damages.[67] However, when this rationale was rooted in prior strict liability and negligence suits, it was not a policy that courts were ready to support in gun litigation. Furthermore, allocating this level of public policy setting power to the judiciary is far beyond the responsibility of the courts or the bounds of tort law. This power is better reserved for legislatures where elected officials decide how to resolve the clash between victims of gun violence and the industry. Nevertheless, one judge in New York has accepted a role in the gun battle by allowing two important gun litigation cases to be heard in his courtroom—a location known for its willingness to hear plaintiffs with innovative product liability theories.[68] The first of those cases was *Halberstam*

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arises regarding the extent of the defendant's original obligation, and the answer often involves the policy of imposing legal responsibility. *See id.* This problem is true of intervening criminal acts that the defendant might reasonably anticipate, but the fact that another's misconduct might be foreseen is not sufficient to place the responsibility on the defendant. *See id.* at 305. However, once it is resolved that the defendant had a duty to anticipate the intervening misconduct, liability may be imposed. *See id.*

61. *See* Bumann, *supra* note 44, at 722.

62. *See* KEETON ET AL., *supra* note 60, § 30, at 165.

63. *See* Bumann, *supra* note 44, at 723.

64. *See id.* Furthermore, criminal acts are so unlikely in any specific instance that to impose a burden on gun manufacturers to take precautions against such acts would almost always exceed the apparent risk. *See* KEETON ET AL., *supra* note 60, § 33, at 197.

65. *See* John P. McNicholas & Matthew McNicholas, *Ultrahazardous Products Liability: Providing Victims of Well-Made Firearms Ammunition to Fire Back at Gun Manufacturers*, 30 LOY. L.A. L. REV. 1599, 1622 (1997).

66. *See id.* at 1604-05.

67. *See id.*

68. U.S. District Court Judge Jack Weinstein is in his late seventies and technically semi-retired, but he maintains an active docket in his courtroom in Brooklyn. *See* Paul M. Barrett, *Aiming High: A Lawyer Goes After Gun Manufacturers; Has She Got a Shot?*, WALL ST. J., Sept.

v. S.W. Daniel, Inc.[69]

III. *HALBERSTAM V. S.W. DANIEL, INC.*: PASSING THE HURDLE OF SUMMARY JUDGMENT

On February 25, 1994, the Jewish holiday of Purim, Baruch Goldstein murdered twenty-nine Palestinian worshippers at a mosque in Israel.[70] Four days later, in retaliation for the massacre, Palestinian Rashid Baz opened fire using two automatic pistols on a van carrying Hasidic Jewish children across the Brooklyn Bridge.[71] One of the pistols, a Cobray M-11/9, which was assembled through a mail-order kit, fired eighteen shots in just a few seconds, killing one child and injuring another.[72] The parents of some of the children sued the owners of the mail-order company, Wayne and Sylvia Daniel, but Judge Weinstein dismissed all the complaints except the allegation of negligent marketing.[73]

The plaintiffs' negligent marketing count relied on the doctrine of negligent entrustment so the plaintiffs could avoid arguing that the manufacturers should refrain from marketing firearms completely.[74] The plaintiffs asserted that the manufacturers owed a duty to the general public to adopt reasonable restraints on the marketing and distribution of their products.[75] However, the defendants countered that no duty existed to refrain from the lawful distribution of a non-defective product.[76] The plaintiffs then argued that the duty did not require the manufacturers to refrain from selling firearms, it only required that they exercise

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17, 1998, at A1. As a judge, he has been nationally known since the 1980s when he helped to design creative solutions to mass injury lawsuits. *See id.* He supported the theory that in some situations when consumers cannot identify the manufacturers of an allegedly harmful product, which often happens in cases involving prescription drugs, all manufacturers can be held liable according to their share of the market at the time of the injury, as opposed to assessing liability on specific proof of fault. *See id.*

69. No. 95 Civ. 3323 (E.D.N.Y. 1998) (pleadings and court orders on file in clerk's office at the U.S. District Court for the Eastern District of New York).

70. *See* Lytton, *supra* note 15, at 686.

71. *See id.*

72. *See id.*

73. *See id.* at 687.

74. *See id.* Negligent entrustment is the theory that a person may be subject to liability for harm that results from entrusting a potentially dangerous object to another whom the giver has reason to know is likely to use it in a manner that poses an unreasonable risk of harm to the recipient or to others. *See id.* at 683 n.7. An example of this theory includes subjecting a person to liability for entrusting a loaded gun to a small child who injures herself or another while playing with the gun. *See id.* at 683. Courts in other jurisdictions have applied the negligent entrustment doctrine to merchants selling firearms to children, intoxicated individuals, ex-convicts, and persons acting suspiciously. *See id.* However, no court has applied the doctrine strictly to firearms manufacturers. *See id.* at 689; *see also* RESTATEMENT (SECOND) OF TORTS § 390 (1986).

75. *See* Lytton, *supra* note 15, at 687.

76. *See id.* at 690.

reasonable care in the promotion and distribution of their products, which could prohibit a manufacturer from advertising the potential criminal uses of its products.[77]

However, the defendants responded that manufacturers have no duty to protect others from the criminal misuse of their products absent a special relationship,[78] which they alleged did not exist in this case.[79] The plaintiffs rebutted by analogizing to other cases where a special relationship was deemed unnecessary. For instance, New York courts previously imposed a duty on BB gun sellers to protect others from the criminal misuse of the weapons, without a special relationship.[80] Therefore, the plaintiffs alleged that a duty arose from the high risk of injury possible from the foreseeable misuse that the retailer created through his selling practices, despite the lack of a special relationship.[81]

The defendants moved for a directed verdict prior to closing arguments, asserting they were under no duty, but Judge Weinstein denied the motion and allowed the case to be resolved by the jury.[82] This refusal marked the first time that such a claim has ever been submitted to a jury.[83] The jury then returned a verdict for the defendants, explaining that their decision was driven by the belief

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77. *See id.* The plaintiffs also suggested that the duty might require the manufacturers to procure the purchaser's background information at the time of the sale because this particular product was purchased through the mail with no such requirements. *See id.*

78. A duty may occur under two situations; first, if there is a special custodial relationship between the manufacturer and the injurer or second, when a special protective relationship between the manufacturer and the victim exists. *See id.* at 691. However, the *Halberstam* defendants also claimed that foreseeability of criminal misuse in New York is relevant only in determining the scope of the duty, not whether it in fact exists at all. *See id.* at 691 n.47 (citing McCarthy v. Sturm, Ruger & Co., 916 F. Supp. 366, 369 (S.D.N.Y. 1996); Strauss v. Belle Realty Co., 482 N.E.2d 34, 36 (N.Y. 1985); Pulka v. Edelman, 385 N.E.2d 1019, 1022 (N.Y. 1976)).

79. *See* Lytton, *supra* note 15, at 691.

80. *See, e.g.*, Earsing v. Nelson, 212 A.D.2d 66, 69 (N.Y. App. Div. 1995).

81. *See id.* Special relationships include custodial relationships, which are those between parents and children and psychiatrists and patients, as well as protective relationships, which are those between landlords and tenants and teachers and students. *See* Tarasoff v. Regents of Univ. of Cal., 551 P.2d 334 (Cal. 1976); Bell v. Bd. of Educ., 687 N.E.2d 1325 (N.Y. 1997); Nallan v. Helmsley-Spear, Inc., 407 N.E.2d 451 (N.Y. 1980).

The plaintiffs tried to illustrate that a special relationship would be irrelevant in this circumstance because a relationship is necessary only in cases of nonfeasance, where the defendant would have failed to intervene to prevent a third party from harming a victim, but a relationship has never been required in cases of misfeasance, where the defendant's conduct creates or increases the risk of a third party harming a victim. *See* Lytton, *supra* note 15, at 691; *see also* Carrini v. Supermarkets Gen. Corp., 550 N.Y.S.2d 710, 712 (N.Y. App. Div. 1990) (holding security firm not liable for injuries caused by thief to bystander for failure to prevent flight of thief absent special relationship between the security firm and bystander).

82. *See* Lytton, *supra* note 15, at 697.

83. *See id.*

that the defendants' marketing practices did not cause the plaintiffs' injuries.[84]

This case is notable in the history of gun litigation because the plaintiffs overcame three obstacles that were fatal to prior plaintiffs in claims against gun manufacturers. First, courts consistently refused to apply the doctrine of negligent entrustment to firearm manufacturers who marketed their weapons to the general public.[85] Traditionally, liability based on this doctrine arose from selling potentially dangerous products to consumer groups that lacked the capacity to exercise ordinary care.[86] However, plaintiffs had failed to solve the problem of alleging that the entire public lacks the capacity to use ordinary care when purchasing a gun because it is the public that actually sets the standard.[87] In *Halberstam*, the judge excused such a deficiency. Second, courts previously viewed negligent marketing claims essentially as design defect claims in disguise, which forced plaintiffs to allege a defective condition in order to recover.[88] In *Halberstam*, the plaintiffs alleged a duty of care that demanded reasonable restrictions on marketing without claiming a defect, which avoided the appearance of trying to completely prohibit the promotion or sale of weapons.[89] This strategy circumvented the prior failures of negligent marketing claims.

Finally, courts often refused to hold defendants liable for injuries inflicted through the intervening, intentional criminal misconduct of others absent a special relationship.[90] The *Halberstam* plaintiffs argued, instead, that the manufacturers owed a duty to the public to take precautions against the intentional criminal misuse of their products where their own promotion and distribution contributed to the risk of such misuse.[91] Therefore, although the jury

84. *See id.* at 697-98.

85. *See id.* at 683. The case of *Linton v. Smith & Wesson*, 469 N.E.2d 339, 340 (Ill. App. Ct. 1984), provides an example of such a refusal. The plaintiff was shot by an intoxicated woman and sued the manufacturer, alleging that a duty existed, "to use 'reasonable means to prevent the sale of its handguns to persons who are likely to cause harm to the public.'" *Id.* at 340. The appellate court held that there was no precedent which imposed a "duty upon the manufacturer of a non-defective firearm to control the distribution of that product to the general public" beyond any statutory regulations, which were not violated. *Id.*

86. *See* Lytton, *supra* note 15, at 683.

87. *See id.* at 684. However, the application of this standard does not take into account the fact that many of the people injured by firearms are not the purchasers, thus those injured will not be protected until the risk to them is considered. *See also* Siebel, *supra* note 12, at 267-68.

88. *See* Lytton, *supra* note 15, at 700-01.

89. *See id.* at 703. Like the plaintiffs in *Halberstam*, the plaintiffs in *Hamilton*, *infra*, argued for a duty which would place restrictions on marketing and distribution, but would not prohibit all marketing; therefore, the negligent marketing claim is distinct from a claim of defective design. *See id.* at 702.

90. *See id.* at 703; *see also* KEETON ET AL., *supra* note 60, § 33, at 201-03.

91. *See* Lytton, *supra* note 15, at 685. Using this approach, plaintiffs must emphasize that they do not seek to hold the manufacturers liable for the conduct of criminals, but only for lesser harms caused by easy access to weapons tailored to criminal activity. *See id.* at 703.

sided with the defendants, the fact that the judge even allowed the jury to hear this case was a significant achievement for the plaintiffs.

While supporters of gun litigation might interpret *Halberstam* as a step towards imposing a duty on gun manufacturers, several considerations temper the value of the decision. Initially, surpassing a motion for summary judgment was a success, but the judge issued no written opinion which could provide support for future plaintiffs.[92] Additionally, the unfavorable jury verdict highlights the lack of persuasive evidence presented to establish the causal connection between the manufacturers' marketing techniques and the criminal misuse of the weapons.[93] A tight connection is essential because juries could easily conclude that had the criminal not purchased the gun at issue, he would have obtained another weapon with which to commit the crime.[94] Plaintiffs will be more likely to convince a jury of causation when they can prove that a defendant's negligent marketing created a new group of people likely to engage in criminal activity who, but for the defendant's efforts, would be less likely to purchase a weapon.[95] Plaintiffs in the next gun suit heard by Judge Weinstein were striving to present such circumstances to the jury.

IV. *Hamilton v. Accu-Tek*[96]

Approximately one year after *Halberstam* was decided, Judge Weinstein heard another case involving the liability of gun manufacturers, which also progressed to the jury for a verdict. This time, the jury decided in favor of the plaintiffs and made legal history in the process.[97]

The motivation for *Hamilton* began when two of the plaintiffs, Freddie Hamilton and Katrina Johnstone, lost family members to gun violence—Freddie lost her son in a gang shooting, and Katrina lost her husband to a robber.[98] Both women approached attorneys at local activist groups about pursuing claims against the industry, but both were disappointed when the groups refused to consider taking on the suits as a result of their lack of success in court.[99] The women then located Elise Barnes, an attorney associated with collective liability litigation in the early 1990s, which also occurred in Judge Weinstein's courtroom. Ms. Barnes steered her case to Judge Weinstein under a local practice rule that permits attorneys to request the services of a particular judge that has handled "related cases" in the past.[100]

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92. *See id.*

93. *See id.* at 704.

94. *See id.* at 704-05.

95. *See id.* at 706.

96. No. 95 Civ. 0049 (E.D.N.Y. 1999).

97. *See* Vanessa O'Connell & Paul M. Barrett, *Gun Makers Are Set Back in Jury Verdict*, WALL ST. J., Feb. 12, 1999, at A2.

98. *See* Barrett, *supra* note 68, at A1.

99. *See id.*

100. *See id.*

A. Legal Strategy of the Case

The plaintiffs' case centered on allegations of negligent marketing and distribution, including the claim that gun companies produce and market more weapons for southern states, where it is easier to purchase a gun, than are actually demanded by legitimate buyers in that region.[101] Consequently, the negligent distribution allegedly allows gun traffickers to move surplus guns to states like New York, where gun control laws are much stricter.[102] Initially, the suit sought class certification and included other theories, like design defect, but the judge denied those claims along with the certification and required the plaintiffs to show that the manufacturers' distribution methods caused each injury.[103]

In 1996, Judge Weinstein allowed the case to move beyond summary judgment in a ruling, which stated:

> [T]here may "come a point that the market is so flooded with handguns sold without adequate concern over the channels of distribution and possession that they become a generic hazard to the community as a whole because of the high probability that these weapons will fall into the hands of criminals or minors."[104]

This decision allowed the plaintiffs to argue that gun companies should be held collectively liable for gun violence without forcing the plaintiffs to prove a link between a particular manufacturer and the gun used in the crime.[105] Furthermore, in his denial of the motion for summary judgment, the judge observed "that the plaintiffs [had] been able to gather extensive material during discovery 'that focuses primarily on coordinated industry activities in opposing government efforts to impose more stringent controls on firearm sales and distribution.'"[106]

B. The Verdict

In the end, the jury found fifteen of the twenty-five gun manufacturers liable

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101. *See* O'Connell & Barrett, *supra* note 97, at A2.

102. *See id.*

103. *See* Gelhaus, *supra* note 9, at 97.

104. Barrett, *supra* note 68, at A1 (quoting Judge Weinstein).

105. *See* Paul M. Barrett, *Pivotal Trial Pits Gun Victims Against Industry*, WALL ST. J., Jan. 4, 1999, at A13. The court surveyed theories of collective liability and found three factors present in all the cases. First, plaintiffs must show that it would be nearly impossible to determine the actual manufacturer responsible for causing the injury. Second, all handgun manufacturers must be shown to have engaged in tortious behavior. Third, "the plaintiffs [must] show that 'the problems of proof are related to the conduct' of the defendants." Tyrone Hughes, Note, Hamilton v. Accu-Tek*: Potential Collective Liability of the Handgun Industry for Negligent Marketing*, 13 TOURO L. REV. 287, 299 (1996) (citation omitted).

106. Hughes, *supra* note 105, at 298 n.62 (citation omitted). These activities included membership in trade organizations, and marketing and distribution. *See id.*

for negligent marketing.[107] However, the jury only imposed total damages of $520,000 on three of the companies for just one of the seven shootings involved in the case.[108] The jurors affirmatively decided that a number of the manufacturers failed to adequately supervise how their wholesalers distribute guns to retail outlets. Most of the jurors, though, rejected the plaintiffs' argument that federal gun statistics show that manufacturers oversupply southern states causing the excess to move north through illegal traffickers.[109] Ironically, even though a number of jurors considered themselves pro-industry, they supported a unanimous verdict that held gun manufacturers as a group legally responsible for the criminal use of their products.[110]

In the end, the jurors disregarded much of the testimony while devising their own system for assessing liability.[111] First, the jurors agreed that manufacturers should discourage sales at gun shows and by dealers who do not have stores; therefore, they separated each company into one of three groups.[112] The companies whose contracts with wholesalers included restrictions for the years at issue and the manufacturers who did not have any contracts were dismissed from any liability. However, the companies whose contracts lacked restrictions were found immediately negligent.[113]

In determining whether any of the negligent companies had directly caused the shootings, the jurors searched through the companies' product catalogues to see which companies produced the types of guns that were used in these crimes.[114] In addition, the jurors decided that most of the plaintiffs were to blame for their damages and thus, did not deserve a financial reward.[115] However, Steven Fox, one of the victims who survived an accidental gunshot wound to the head, was awarded damages because he was so young. The jurors agreed that $4 million was appropriate, but only three of the negligent manufacturers produced the type of gun used against Fox.[116] Additionally, those three companies only held about thirteen percent of the sales in the handgun market.[117] Therefore, Fox was awarded $520,000.[118]

After the verdict, the defense moved to have the verdict set aside, but Judge

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107. *See* Hamilton v. Accu-tek, 62 F. Supp. 2d 802, 808 (E.D.N.Y. 1999); O'Connell & Barrett, *supra* note 97, at A2.

108. *See Hamilton*, 62 F. Supp. 2d at 808. For a list of the companies found negligent, see *id.* at 811.

109. *See* O'Connell & Barrett, *supra* note 97, at A2.

110. *See* Paul M. Barrett & Vanessa O'Connell, *Gun Makers, Claiming Jury Misconduct, Seek to Throw Out Negligence Verdict*, WALL ST. J., Feb. 17, 1999, at B11.

111. *See* O'Connell & Barrett, *supra* note 1, at A1.

112. *See id.*

113. *See id.*

114. *See id.*

115. *See id.*

116. *See id.*

117. *See id.*

118. *See id.*

Weinstein denied the motion.[119] He noted that "[w]hile New York courts have ruled that '[s]elling a dangerous product is not unlawful, . . . there is a subtle but distinctly different claim in the present case, i.e. that while the sale of a weapon is not in itself tortious, the method of sale and distribution by producers may be.'"[120] To support levying a duty against manufacturers for their distribution and marketing practices, the judge recited statistics, which showed that in twenty-seven cities between 1996 and 1998, fifty-one percent of guns used in crimes by juveniles or people between the ages of eighteen and twenty-four were acquired by intermediaries who purchased them directly from legitimate, licensed dealers.[121] The judge also stated:

> It is the duty of manufacturers of a uniquely hazardous product, designed to kill and wound human beings, to take reasonable steps available at the point of their sale to primary distributors to reduce the possibility that these instruments will fall into the hands of those likely to misuse them. Such a limited duty is consistent with manufacturers' traditional broad duties . . . .
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> . . . .
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> Manufacturers who market and distribute handguns negligently set the stage for their criminal misuse.[122]

The judge concluded that: "It cannot be said, as a matter of law that reasonable steps could not have been taken by handgun manufacturers to reduce the risk of their products being sold to persons likely to misuse them—a point which is underscored by the jury's findings on causation . . . ."[123]

C. Impact of the Case

After the verdict was announced, both plaintiffs and defendants claimed victory.[124] Defense attorney James Dorr noted the modest damage award while stating that the decision was clearly a verdict for the defense because the jury rejected the plaintiffs' main argument concerning the oversupplied southern markets.[125] Furthermore, the companies were released from not one, but six wrongful death cases.[126] Conversely, plaintiffs claimed a major victory with the negligence of fifteen of the companies confirmed, even though only three of

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119. *See* Mark Hamblett, *Verdict Against Gun Makers Upheld*, N.Y. L.J., May 27, 1999, at 2.

120. *Id.* (quoting Judge Weinstein).

121. *See* Hamilton v. Accu-Tek, 62 F. Supp. 2d 802, 825-26 (E.D.N.Y. 1999).

122. *Id.* (quoting Judge Weinstein).

123. Hamblett, *supra* note 119, at 2 (quoting Judge Weinstein).

124. *See* O'Connell & Barrett, *supra* note 97, at A2. However, the defense has continued to contest some aspects of the case. *See id.*

125. *See id.*

126. *See* Bob Van Voris, *Lawyers Debate Who Won Gun Suit*, NAT'L L.J., Mar. 1, 1999, at A6.

twenty-five defendants were assessed damages, because gun manufacturers had never before been held liable on theories of negligent marketing or distribution.[127] However, even some jurors were unsure which party was victorious. One juror stated: "Really the plaintiffs lost because they had the burden of proof, and in the end, there wasn't enough there . . . . I didn't grasp that we had found so many negligent until I read it in the papers the next day."[128]

Overall, the *Hamilton* verdict is highly unlikely to provide any legal boost to plaintiffs in gun suits around the country for several reasons. First, the verdict was a mixed decision where many of the companies were found liable, but no damages or other real penalty for their activities was assessed.[129] Second, the wholesalers, who were originally named as defendants, were dismissed for lack of evidence,[130] and out of the twenty-five defendants who remained, only $520,000 in damages was assessed against three of the companies. The decision was also very fact-specific and difficult to predict. Furthermore, New York is a very favorable jurisdiction in which to try new theories of products liability, especially in front of Judge Weinstein, who is well-known for keeping an open mind about innovative tort claims. For these reasons, other jurisdictions will not likely afford the *Hamilton* verdict much precedential weight when confronted with their own gun litigation.

Beyond the circumstances of *Hamilton*, other hurdles exist as well. For example, issues of causation and the related public policy decisions necessary to hold gun makers liable for criminal acts are still hotly debated. As this verdict illustrates, the jury was unwilling to compensate all of the victims and refused to assess large damage awards, which illuminates the weakness of the plaintiffs' verdict. However, many cities around the country are hoping to gain leverage against gun manufacturers using *Hamilton* as ammunition.

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127. *See id.* There are several reasons why the theory of negligent distribution has never been successful for plaintiffs and may continue to prove difficult in the future. *See* Note, *Handguns and Products Liability*, 97 HARV. L. REV. 1912, 1921 (1984). First, handgun manufacturers have no practical means to identify which of their thousands of potential customers will misuse the product, and the industry would have a difficult time designing a stricter distribution system without precluding legitimate buyers from acquiring guns. *See id.* Additionally, the courts' informal inquiries into distribution methods would create inconsistent results. In a specific example, the plaintiff would have to show that his attacker would not have come to possess the gun had the manufacturer not used the defective system of distribution in question. *See id.* at 1921-22. If the criminal could have acquired the gun through other means, the plaintiff would have to be denied any recovery. A final concern involves the fact that many guns used in crimes have been stolen from the original purchaser, and if manufacturers tried to tighten the distribution system, the black market for guns could explode, allowing the problem to continue. *See id.* at 1922.

128. O'Connell & Barrett, *supra* note 1, at A1.

129. *See id.*

130. *See* Vanessa O'Connell, *Judge Drops Gun Wholesalers as Defendants in Landmark Case*, WALL ST. J., Jan. 27, 1999, at B15.

V. City Suits Against the Gun Manufacturers

Hoping to achieve financial success similar to the state attorneys general who were able to negotiate a settlement with tobacco companies after asserting legal claims against the industry, the mayors of almost thirty cities around the country have filed suits against gun manufacturers.[131] The cities' attorneys believe their suits may have a unique advantage over cases brought by individual plaintiffs because of the shift in the focus of the litigation. Cases filed by individuals have consistently fallen short on issues of causation and duty because the industry can point to a third party who actually committed a criminal act, breaking the chain of causation.[132] However, similar to the states' tobacco claims, causation and duty problems are reduced when a municipality, who alleges it did not share in the responsibility for the harm, sues for the foreseeable damages it has suffered.[133] The focus of these claims is not on the injuries to the victim, but on the harm experienced by cities as a whole from the practices of the industry regarding marketing, distribution, and safety devices.[134] In such cases, the cities' attorneys insist that no new legal theories are needed because they can utilize several traditional tort theories such as public nuisance and negligence.[135]

A. The Legal Claims

New Orleans and Chicago initiated the battle by filing the opening lawsuits against the gun industry to recover police, emergency, and medical services expenses from accidental shootings and homicides.[136] New Orleans filed first on October 30, 1998, and its suit asserts that guns manufactured and sold without locking devices or adequate safety warnings are unreasonably dangerous and defective.[137] The city also alleges that gun makers are capable of "personalizing" weapons, but have neglected to pursue this technology.[138] The suit names gun

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131. *See* Matt Bai, *The Feds Fire a Round*, NEWSWEEK, Dec. 20, 1999, at 38.

132. *See* Kairys, *supra* note 5, at 12-13. This is similar to the problems that plaintiffs in tobacco cases were forced to confront—regardless of the problems with cigarettes, the smoker continued to smoke, thus sharing in the responsibility of the injury to his or her health. *See id.*

133. *See id.* at 13. The harm inflicted on the cities through the marketing and distribution practices of the industry is quite diverse, but it can include medical costs, and the expenses of police, emergency personnel, public health, human services, courts, prisons, sheriff, fire, and other services. *See id.*

134. *See id.*

135. *See id.*

136. *See* Lisa Gelhaus, *Cities Contemplate Filing Anti-Handgun Lawsuits*, TRIAL, Jan. 1999, at 96, 98.

137. *See id.* Behind these allegations are statistics showing that every day approximately one child is killed and as many as thirteen more are injured in unintentional shootings. *See* Siebel, *supra* note 12, at 253.

138. *See* Barrett, *supra* note 8, at A3; *see also* Siebel, *supra* note 12, at 257-58 (stating that changing gun design is analogous to changes that the auto industry made to improve safety features like designing more crash-resistant vehicles, and offering seatbelts and airbags).

manufacturers, gun associations, and area pawnshops as defendants.[139] The mayor of New Orleans explained his motivation for the suit when he stated, "[t]he continuing senseless deaths of children and other citizens make it very difficult for me to sit around a table and negotiate as thousands of handguns are pumped into our streets every year."[140] The mayor is hopeful that this suit and others like it might be able to place enough pressure on the industry to compel manufacturers to innovate significant safety designs.[141]

Chicago's suit takes a different approach and targets the loose distribution practices of the industry.[142] It uses a public nuisance statute as the legal anchor for its $433 million claim because the city has some of the most restrictive gun laws in the country. These laws prohibit handgun sales and private ownership of handguns unless registered before 1982.[143] However, despite such restrictive laws, an undercover operation by Chicago police[144] revealed that the city had a severe gun trafficking problem; thus the suit alleges that gun manufacturers and dealers facilitate trafficking by selling guns with the knowledge that they will be used in crimes.[145] The suit also claims that the defendants create a public nuisance because they knowingly design, market, and distribute firearms to facilitate their entry into Chicago where they are illegal to possess.[146] Furthermore, the suit asserts that manufacturers "knowingly oversupply" gun stores located outside the borders of the city with more weapons than the lawful

139. *See* Gelhaus, *supra* note 136, at 88.

140. *Id.* (quoting New Orleans Mayor Marc Morial).

141. *See* Siebel, *supra* note 12, at 263.

142. *See id.* at 268.

143. *See* Barrett, *supra* note 8, at A3.

144. Operation Gunsmoke investigated twelve stores around Chicago where the highest number of guns traced to crimes in the city were sold. *See* Siebel, *supra* note 12, at 279. The undercover officers purchased 171 guns over a span of three months and "openly bragged [to dealers] about needing the guns to 'settle a score,'" reselling the guns to drug gangs, or using them in other criminal ventures. *Id.* at 280. In each case, the dealers sold the guns to the officers. *See id.*

145. *See* Barrett, *supra* note 8, at A3.

146. *See id.* However, with the failure of a similar illegal trafficking argument in *Hamilton*, this allegation will be difficult to prove. David Kairys, a law professor at Temple University in Philadelphia, designed the approach that by flooding certain areas with guns inevitably used in crime, the industry disrupts public safety and health. He claims that lawsuits against the industry have failed in the past because the problem is that handguns are not defective, but that they work too well. Therefore, he hopes to shift a jury's attention toward the harm done to the community as a whole. *See id.*; *see also* Kairys, *supra* note 5, at 14 (stating that handgun manufacturers' marketing, distribution, and promotion of their products, designed to instantaneously deliver lethal force, significantly interferes with a public right and creates a public nuisance by "(a) flooding neighborhoods and communities with handguns; (b) making handguns easily available to persons with criminal intentions, felons, and minors; (c) confusing and deceiving law-abiding purchasers about the great risk of possession of a handgun in the home and of concealed carrying of a handgun in public places; and (d) failing to provide potential purchasers with appropriate warnings").

market could absorb, with the intention that many guns will move into the black market.[147] Chicago Mayor Richard Daley defended his position by stating, "[g]un manufacturers and retailers know exactly what they're doing [when they] refuse to impose even the most basic controls [on distribution of their products]."[148] Following Chicago's lead, more cities joined the litigation as San Francisco, Cleveland, Los Angeles, Atlanta, and Bridgeport filed similar suits to offset their cities' gun-related expenses.[149]

As more cities filed suits, the cases began to model the two main theories of liability previously alleged by New Orleans and Chicago. For example, Atlanta's lawsuit is very similar to the case filed by New Orleans, alleging that gun makers do not use adequate safety devices to keep unauthorized users, like children, from using the weapons.[150] The suit also claims that guns are "inherently and unreasonably dangerous" because anyone can fire them and they are not issued with sufficient warnings and instructions about danger and storage.[151] Furthermore, Atlanta asserts that guns are promoted to suggest that they are unrealistically safe. After filing the city's lawsuit, the mayor of Atlanta, Bill Campbell, stated:

> It has come time for us to hold gun manufacturers to the same standards that we hold cars, insecticides, medicines and a host of other inherently dangerous products. They can be made safer, they should be made safer, and we think this is the opportunity and the time to do so. . . . We're not trying to abridge the Second Amendment . . . . What we're saying, however, is that there's a problem with the manufacture of this product that has an inherently dangerous nature that could be improved.[152]

The suit seeks an unspecified amount of damages to recover the costs of police protection, emergency services, facilities and other services attributable to the threat of guns, and reduced tax revenue due to lost productivity.[153]

Gun industry officials publicly responded that their products already come with safety devices and instructions, and they cannot absolutely guard against an

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147. Barrett, *supra* note 8, at A3.

148. *Id.*

149. *See* Paul M. Barrett & Shirley Leung, *Gun Industry Faces Court Challenge from Los Angeles and San Francisco*, WALL ST. J., May 25, 1999, at B3. One professor suggests that the cities are pursuing the legitimate goal of placing the cost of guns on the lowest cost avoider, which supposes that the losses in a products liability suit should be placed on the party who can best analyze the problem and do something about it. *See* Vandall, *supra* note 18, at 569. Accordingly, manufacturers know what types of guns are produced, who buys them, how they are used, what types of injuries occur, and these companies have the power to increase the costs of guns, redesign the products for better safety, or remove them from the market. *See id.*

150. *See* Jay Croft & Carlos Campos, *Gun Makers, NRA Vow to Fight City's Lawsuit*, ATLANTA J., Feb. 5, 1999, at A1.

151. *Id.*

152. *Id.*

153. *See id.*

owner's carelessness.[154] An attorney for Beretta U.S.A. Corporation, one of the defendants named in the suit, stated, "[t]here's no gun made that can't be locked. The ultimate decision to lock or not lock a gun lies with the owner, and there are many customers who do not want to lock a gun."[155] Atlanta Senate Minority Leader Eric Johnson also spoke out against the city:

> I think they're making a mistake suing legal business for legal products and expecting them to be held accountable for the abuses of citizens. I'd hate to think we're in a situation where we could sue Ford for cars (that are driven improperly) or Nike for shoes that people get their ankles twisted in.[156]

B. The First Effects of the Legal Battle

The wave of city suits filed against gun manufacturers has initiated some restructuring in the industry as one California manufacturer pulled out of the cheap gun market entirely.[157] Additionally, both the pro and anti-gun camps have predicted that a prolonged litigation process could result in the disappearance of some of the smaller gun makers, an increase in prices, and greater stability with the larger players who may be more willing to accept regulations.[158]

In fact, in March 2000, Smith & Wesson stepped out of industry ranks by agreeing to a deal where the company promised to make specific safety advances, such as incorporating high and low-tech locks on its weapons and reorganizing its relationships with dealers by requiring new restrictions on how its guns are sold.[159] In exchange for these concessions, the federal government, along with the states of New York and Connecticut, agreed not to name Smith & Wesson in suits they threatened to file against the industry.[160] In addition, at least fifteen of the cities that sued the industry agreed to drop Smith & Wesson from their suits.[161] However, the deal the federal government thought would encourage other manufacturers to agree to restrictions quickly deteriorated when the NRA began to flex its muscles and a Republican took over the White House. In fact, Smith & Wesson "ran face first into a gun lobby at the height of its power, and

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154. *See* Jay Croft & Carlos Campos, *Defying Foes at Capitol, Atlanta Sues Gun Makers*, ATLANTA CONST., Feb. 5, 1999, at A1.

155. *Id.*

156. *Id.*

157. *See* Paul M. Barrett & Alexel Barrionuero, *Guns: Handgun Makers Recoil as Industry Shakes Out*, WALL ST. J., Sept. 20, 1999, at B1.

158. *See id.*; *see also* Bai, *supra* note 131, at 38 (stating that one Colt plant was forced to lay off over 300 employees while other gun manufacturers across the country admit to feeling the pressure from the mounting legal bills).

159. *See* Paul M. Barrett & Vanessa O'Connell, *Austrian Firm May Follow Lead of Smith & Wesson to Avoid U.S. Sanctions*, WALL ST. J., Mar. 20, 2000, at A3.

160. *See id.*

161. *See id.*

a gun culture hostile to change."[162] Immediately after the deal was signed, the NRA sent scathing messages to more than three million of its members, calling Smith & Wesson a British-owned traitor to the Bill of Rights.[163] After a painful consumer boycott and deafening protests from its retailers, Smith & Wesson pulled out of the agreement.[164]

Other gun makers have sworn off a fight and taken a different approach. In September 1999, three California manufacturers who made cheaper guns commonly associated with crime declared bankruptcy as a way to avoid the lawsuits filed by the nearly thirty municipalities.[165]

C. The NRA's Response to the Cities' Lawsuits

The NRA, a powerful lobbyist organization, vowed to fight back against the city suits with the help of several states by endeavoring to get both state and federal legislation passed that would either prevent municipalities from filing suits against the industry or would set damage limits on any verdicts.[166] The organization has already succeeded in getting legislation passed in at least one house of the state legislatures in fourteen states, which precludes local governments from taking legal action against gun manufacturers, and as many as twenty more states could pass similar bills in the future.[167]

The first state to pass such legislation was Georgia, whose bill shields gun manufacturers from product liability suits brought by cities or counties.[168] Both houses of the Georgia legislature passed the measure with strong bipartisan majorities, with the Senate voting forty-four to eleven and the House voting one hundred and forty-six to twenty-five.[169] A similar bill introduced in Florida would make it a crime punishable up to five years in jail with a $5000 fine for any local government official to file a suit against gun manufacturers.[170] The bill

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162. Matt Bai, *A Gun Deal's Fatal Wound: As a Landmark Pact to Control Gun Sales Falls Apart, Smith & Wesson Takes the Hit*, NEWSWEEK, Feb. 5, 2001, at 30.

163. *See id.*

164. *See id.*

165. *See* Paul M. Barrett, *Some Small California Gun Firms File Under Bankruptcy Code as Cities Sue*, WALL ST. J., Sept. 13, 1999, at B10.

166. *See* Gelhaus, *supra* note 9, at 98.

167. *See* Michael Janofsky, *Concerns About Guns Put New Pressure on State Legislators*, N.Y. TIMES, Jan. 5, 2000, at A12.

168. *See* Gallia, *supra* note 52, at 160.

169. *See* Firestone, *supra* note 10, at A1. The Georgia law states in part, "[t]he authority to bring suit and right to recover against any firearms or ammunition manufacturer, trade association, or dealer by or on behalf of any governmental unit . . . shall be reserved exclusively to the state." GA. CODE ANN. § 16-11-184(b)(2) (2000). Importantly, the official text of the statute does not include a retroactive provision. *See id.*

170. *See* David Nitkin & Jay Weaver, *State Drops Bills Banning Suits Against Gun Makers*, FORT LAUDERDALE SUN-SENTINEL, Apr. 28, 1999, at 5B. The Florida "bill states that guns and ammunition are 'lawful and not unreasonably dangerous' and prohibits a gun from being 'deemed

also includes a retroactive provision that could quash the suit filed by Miami in January 1999, which seeks to hold manufacturers liable for what the city spends on police and hospital services as a result of gun violence.[171] After devoting significant time and energy to instigating these bills, the NRA vowed to concentrate on states where the governor was likely to sign such a bill to preempt as much legislation as possible.[172]

The legislation was defended by NRA vice president, Wayne LaPierre, who stated,

> What the mayors are going to find out is that a direct attack on the freedom to bear arms is the toughest briar patch they can jump into . . . .
>
> They think there is no cost, and this is a way to a quick buck, like tobacco money. But their cost, politically and economically, is going to be high, because we're determined to expose this for the sham that it is.[173]

An attorney for one of the defendants in the Atlanta suit, Beretta U.S.A. Corporation, agreed: "It strikes me as inappropriate for the mayor of a city to try to use, through harassing litigation, what he's unable to accomplish through persuasion at the legislative level . . . ."[174] U.S. Representative Bob Barr, who helped pass the Georgia legislation, explained his actions by stating:

> The possibility of imposing liability on an entire industry for harm that is the sole responsibility of others is an abuse of the legal system . . . . The liability actions commenced or contemplated by municipalities and cities are based on theories without foundation in hundreds of years of the common law and American jurisprudence.[175]

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defective' because it" may have been used in a crime. Gelhaus, *supra* note 9, at 98 (citation omitted). James J. Baker, chief lobbyist for the NRA, stated, "[w]e are responsible for the Florida legislation . . . . The point is to try to get rid of the suits that have already been filed [and to target] as many as [twenty-five] or [thirty] states where local officials are considering suing." Sharon Walsh, *NRA Moves to Block Gun Suits; Bills in [Ten] States Would Bar Action by Local Officials*, WASH. POST, Feb. 26, 1999, at A1. Dennis Henigan, legal director of the Center to Prevent Handgun Violence, a nonprofit organization helping Miami in its suit, responded, "[w]e think this is an outrageous attempt to prevent Miami-Dade from asserting the legal rights of its citizens . . . . We allow ordinary citizens and cities to assert their rights in court. If a suit is frivolous, the courts have a right to sanction. . . . But we don't threaten people with jail . . . ." *Id.*

171. *See id.*

172. *See id.* This is not the first time that the NRA has attempted to head off the efforts of anti-gun activists—in the 1980s when some jurisdictions passed gun control laws, the NRA approached other regions to pass bills that would prohibit such statutes. *See id.*

173. Croft & Campos, *supra* note 150, at A1 (quoting Wayne LaPierre, NRA vice president).

174. *Id.* (quoting Jeffrey Reh, attorney for Beretta U.S.A. Corp.).

175. Paul Frisman, *Gun Suits Head Down Tobacco Road, Bridgeport Shoots from the Hip to Recover Police and Health Care Costs*, CONN. L. TRIB., Apr. 12, 1999, at 1 (quoting U.S.

Accordingly, Dan Coenen, a law professor at the University of Georgia, predicted that if the gun legislation is upheld with the retroactive provision, the days of Atlanta's lawsuit are numbered.[176] "The city of Atlanta . . . would be viewed by the courts as an arm of the state . . . . Therefore the state Legislature would be able to limit what the city of Atlanta can do in this area."[177]

Many other state legislatures have been active in proposing similar bills, like Pennsylvania, where the Senate approved a bill thirty-nine to eleven, which prohibits cities from suing gun manufacturers.[178] Oklahoma passed a bill in June 1999 that reserves to the state the right to sue arms manufacturers for damages relating to the sale, manufacture or design of firearms and ammunition.[179] However, this bill does not prevent cities and towns from suing for breach of contract or warranty, and it does not prevent individuals from filing suits.[180] Additionally, the State Assembly in Wisconsin passed a bill in a seventy-five to twenty-one vote that prohibits both governments and individuals from suing gun makers and dealers for the costs of gun violence, unless the gun was defective or negligently sold.[181]

U.S. Representative Bob Barr also introduced a bill in Congress that would protect gun manufacturers by prohibiting lawsuits filed by cities across the country.[182] Barr, a Georgia Republican and an NRA board member, stated that federal legislation was needed to preserve free enterprise and halt the get-rich schemes of trial lawyers who attempt to take on big industries.[183] Furthermore, he supported his bill by explaining, "[i]f these lawsuits are allowed to proceed . . . there will be no industry in America that will be safe from these abusive and predatory lawsuits."[184] Conversely, Senator Barbara Boxer, a California Democrat, intends to introduce an opposing bill to preserve the rights of municipalities to sue gun manufacturers.[185] She stated, "[i]f local governments believe the fight against crime is being hampered because of a mass proliferation of guns, I believe it is in the national interest to allow them to take action in

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Representative Bob Barr from Georgia).

176. *See* Bill Rankin, *Change in State Law Could Derail Atlanta Suit*, ATLANTA J., Feb. 7, 1999, at G5.

177. *Id.* (quoting Dan Coenen, Professor at University of Georgia).

178. *See Senate Amends Bill to Include Ban on Gun Suits*, PA. L. WKLY., Nov. 22, 1999, at 2.

179. *See* Marie Price, *Late Bill Bans Cities from Suing Gun Manufacturers*, OKLA. CITY J. REC., June 9, 1999, at A1.

180. *See id.*

181. *See* Anthony Jewell, *Bill to Shield Gun Sellers Gains Assembly Oks, Some Immunity from Lawsuits*, WIS. ST. J., Feb. 9, 2000, at 3B.

182. *See* Lizette Alvarez, *A Republican Seeks to Ban Suits Against Gun Makers*, N.Y. TIMES, Mar. 10, 1999, at A16.

183. *See id.*

184. *Id.* (quoting Republican U.S. Representative Bob Barr from Georgia).

185. *See id.*

court."[186] However, as the legislation struggle continues, many supporters of gun litigation are turning their sights away from the courtroom and towards the negotiating table where they hope to achieve a settlement similar to the tobacco deal.

D. Similarities to Tobacco Claims

Anti-gun groups are hoping the NRA does not destroy their chances to have their cases heard in court, or at least their chances to follow the path of tobacco litigation to a negotiated deal.[187] Professor Lester Brickman explained the approach:

> The strategy is to emulate what took place in the tobacco wars .... What the plaintiffs' lawyers relied on was their political ability to bring in enough states to reach a threat level that would cause the tobacco companies to cave in.
>
> If they can get 20 suits going on, they could raise the cost to the gun manufacturers to $1 million a day.[188]

The similarities in the industry suits have motivated anti-gun groups to continue their litigation battles. For example, the group of attorneys that played an integral role in the tobacco litigation are also intimately involved in the gun litigation, initiating and consulting in several of the suits.[189] However, an important key in the tobacco deal was the damaging information released by the whistleblowers that threatened the industry, and thus far, the gun companies say they will escape similar threats.[190] Another similarity in the suits involves their strategy. Anti-gun activists are calling the structure of these suits "the tobacco model"—government entities file well-financed lawsuits, the discovery process probes deeper into how the companies do business, and it is hoped that one of the suits stays in court.[191]

The allegations in the cities' suits also bear similarities to the tobacco litigation. For example, New Orleans has alleged that gun companies have failed to make safer guns that can only be fired by an authorized user, which is similar to the states' claims that tobacco companies blocked the development of a safer cigarette.[192] Further, several cities have claimed that gun companies are targeting markets with lax gun laws, causing weapons to flow to criminals, as tobacco

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186. *Id.* (quoting Democrat Senator Barbara Boxer from California).

187. *See* Paul M. Barrett, *Jumping the Gun? Attacks on Firearms Echo Earlier Assaults on Tobacco Industry*, WALL ST. J., Mar. 12, 1999, at A1.

188. Laura Mansnerus, *Moving Target: Gun Makers*, N.Y. TIMES, Feb. 14, 1999, at D5.

189. *See* Barrett, *supra* note 187, at A1.

190. *See id.*

191. *See* Michael Higgins, *Taking Their Best Shot: Fed up with Gun Violence, Some Cities May Copy an Illinois Father's Tobacco-Style Suit Against Gun Makers*, A.B.A. J., Aug. 1998, at 79, 81.

192. *See* Barrett, *supra* note 187, at A1.

companies were accused of targeting minors for cigarette sales. The plaintiffs' attorneys are hoping that these similarities, along with the threat of lawsuits and federal regulation, will force gun companies to agree to a deal, much like the tobacco industry.[193] However, although the comparisons seem strong, there are also many differences working against the cities who seek to pursue litigation.

VI. The Future of Gun Litigation

In light of the *Hamilton* verdict and the numerous city suits that have been filed, many anti-gun activists are optimistic about the future of gun litigation. However, their optimism is unfounded because the shaky and wide-ranging product liability theories of *Hamilton* do not provide a persuasive precedent. Furthermore, judges across the country are not ready to support such a battle, as evidenced by the continued failure of lawsuits against the industry.[194] Nor is the public ready to impose such serious sanctions on a legal and useful product with such a long history and sense of meaning in our society. Additionally, the city suits will not conclude with the large monetary success that some tobacco plaintiffs enjoyed because of vast differences in the industries. However, imposing restrictions on manufacturers through negotiations might be a more attainable goal if one or more of the city suits can avoid dismissal. Therefore, plaintiffs' dreams of a future filled with dramatic jury trials and overwhelming verdicts will remain unrealized, but it is unlikely that the industry will be able to remain completely uninfluenced by the efforts to allay society's concerns about gun violence.

A. The Value of Hamilton

First, it will be very difficult for other individuals to repeat the *Hamilton* verdict or find greater success in suits against gun manufacturers.[195] Regardless of how the plaintiffs have tried to recast the verdict, the decision has definitely

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193. *See id.*

194. *See* Hughes, *supra* note 105, at 287, 305 n.1.

195. *See* Patterson v. Rohm Gesellschaft, 608 F. Supp. 1206 (N.D. Tex. 1985). The mother of a convenience store clerk killed in a robbery brought a products liability action against the manufacturer of the handgun alleging the risks of injury and death from a non-defective revolver greatly outweighed any utility the gun had, making the product unreasonably dangerous. *See id.* at 1208. The court held the defendant not liable while stating:

> This claim is totally without merit and totally unsupported by legal precedent. It is a misuse of tort law, a baseless and tortured extension of products liability principles. And, it is an obvious attempt—unwise and unwarranted, even if understandable—to ban or restrict handguns through courts and juries, despite the repeated refusals of state legislatures and Congress to pass strong, comprehensive gun-control measures.

Id. Furthermore, the court addressed the argument that gun manufacturers are better able to absorb the loss than victims. *See id.* at 1213. The court explained that the tort system is based on fairness and the ability of a gun manufacturer to spread the loss is not a sufficient basis for requiring guiltless purchasers to subsidize the actions of those who use the products wrongfully. *See id.*

sent mixed signals. Only fifteen of the twenty-five defendants were found liable, and that group was only composed of the manufacturers who sold their products at gun shows and to dealers who did not have stores.[196] The jurors were otherwise unwilling to impose greater liability. Furthermore, in the jurors' haphazard way of assigning liability, the majority of the fifteen negligent defendants were assessed no damages.[197] This fact sends a message that only the most minimal standards could be agreed upon for the assessment of liability, and no practical consequences were felt by the twelve companies who were not assessed any monetary damages. In addition, the damages amounted to only $520,000, or $173,333 per the three companies assessed damages, which is a relatively weak penalty from the jury.[198]

Aside from the verdict, Judge Weinstein is also widely known for his openness to new theories of accountability in products liability cases, and it could be difficult to locate a judge as sympathetic in another jurisdiction.[199] As this jury illustrated, the behavior of juries in general is very difficult to predict, which also adds to the low probability that this verdict could be repeated or surpassed. Therefore, this decision provides no real support for future plaintiffs.[200] For example, in *McCarthy v. Sturm, Ruger & Co.*,[201] the plaintiffs sued the ammunition manufacturer after they were struck by bullets fired in a subway shooting spree.[202] The judge quickly dismissed the case on summary judgment because he believed the manufacturer owed no duty to protect third parties from the criminal misuse of its products.[203] In closing, the court noted the plaintiffs' claims "seek legislative reforms that are not properly addressed to the judiciary. . . . I too would work to ban ammunition like the Black Talon if I was a member of the New York legislature. As judges, though, we both are

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196. *See* O'Connell & Barrett, *supra* note 97, at A2.

197. *See id.*

198. *See id.*

199. *See* Barrett, *supra* note 68, at A1.

200. *See* O'Connell & Barrett, *supra* note 1, at A1.

201. 916 F. Supp. 366 (S.D.N.Y. 1996). Contrary to Judge Weinstein's views, the *McCarthy* judge stated that New York would not recognize a duty running to all those affected by the use of bullets created simply by the act of marketing the bullets. *See id.* at 369-70. On this point, the court held that the advertisements did not emphasize qualities that would make them more attractive to criminals, any more than any other comparable product on the market. Therefore, to hold that the advertisements were negligent would hold the defendant liable for the manufacture of the product with these distinguishing characteristics. *See id.* at 369. Furthermore, the hollow-point bullets, which were designed to expand on impact, were created with the functional design of an inherently dangerous product, thus preventing any claims based on design defects or unreasonable dangerousness. *See id.* at 370. Finally, the individual's conduct was an extraordinary act that broke the chain of causation. *See id.* at 372. The judge stated, "[b]oth of plaintiffs' negligence theories fail because defendant owed no duty to the plaintiffs to protect them from criminal misuse of the Black Talon ammunition." *Id.* at 369.

202. *See id.* at 370.

203. *See id.* at 372.

constrained to leave legislating to that branch of the government."[204]

Most importantly, the issues of causation and fault raised in these suits are especially challenging because of the broader public policy decisions that are shadowed in the alternatives. To impose liability on a manufacturer of a legal product for the criminal misuse of that product months or even years later supposes a kind of responsibility that our society has yet to impose on other industries.[205] Furthermore, although lawsuits are now common, this type of liability could usher in a new era in the legal community, encouraging countless more suits alleging similar responsibility. The dynamics of playing an open-ended liability game in the courtroom are risky and under-appreciated. Ralph Boyd Jr., a Boston lawyer who has consulted with the gun industry, succinctly explained:

> The auto industry makes vehicles that exceed by two the lawful speed limit in any jurisdiction . . . . What would stop someone from using this type of legal theory from saying, "Hey, you know those commercials that show cars speeding across the countryside, making tight turns on mountains, zipping around pylons on race courses? Why isn't that negligent marketing? Why isn't the auto industry responsible for all the accidents resulting from excessive speed?"[206]

B. The Prospects of the Cities' Suits

Although one plaintiff in *Hamilton* received a weak verdict that could be labeled a success against the gun industry, the cities that have sued will not realize success in court. Bridgeport, Miami-Dade, and Cincinnati can attest to this as all three suits were dismissed at the end of 1999.[207] On December 10, 1999, the Bridgeport suit was dismissed when superior court Judge Robert McWeeny held that the city lacked standing to sue the gun industry.[208] The judge decided that the injuries of which the city complained were too remote and not

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204. *Id.*

205. *See* Bumann, *supra* note 44, at 723.

> Criminal acts generally intervene to break the chain of causation: "Under . . . ordinary circumstances, it is not reasonably [sic] to be expected that anyone will hurl a television from an apartment building, rob and beat up a boy in a public restroom, forge a check, push another man into an excavation, abduct a woman from a parking lot and rape her, hold up a patron in the parking lot of a bank, or shoot a patron in the parking lot of a restaurant. Although such things do occur, a [sic] must be known to anyone who reads the daily papers, they are still so unlikely in any particular instance that the burden of taking continual precautions against them almost always exceeds the apparent risk."

Id. (quoting KEETON ET AL., *supra* note 60, § 33, at 201).

206. Mansnerus, *supra* note 188, at D5 (quoting Ralph F. Boyd, Jr., a Boston lawyer).

207. *See County's Suit Against Gun-Makers Dismissed*, ORLANDO SENTINEL, Dec. 14, 1999, at D3.

208. *See* Paul Frisman, *Sticking to Their Guns*, CONN. L. TRIB., Dec. 27, 1999, at 1.

recoverable. "It is recognized at common law . . . that a plaintiff who complains of harm resulting from misfortune visited upon a third person is generally held to stand at too remote a distance to recover."[209] With regard to the cities' analogy to the tobacco industry cases, Judge McWeeny responded: "The tobacco litigation . . . has not succeeded in eradicating the rule of law on proximate cause, remoteness of damages and limits on justiciability."[210] He also explained that unlike the cities in gun cases, the states that sued the tobacco industry were authorized to do so by state law under "the state's unique role relative to protection of its citizens."[211] Finally, the judge viewed the question of damages skeptically, stating that "[c]alculating the impact of gun marketing on teen suicide and diminution of property values in Bridgeport would create insurmountable difficulties in damage calculation . . . . Plaintiffs cannot seriously maintain that reasonable certainty in calculating their damage claims is within the realm of possibility."[212]

In addition to the likelihood of court dismissals, the suits filed by the cities do not have the power to force a substantial financial settlement, unlike the states that faced-off with the tobacco industry. More specifically, the cities' legal fight over guns lacks the elements that were critical in achieving large damage awards in the tobacco litigation.[213] First, guns can be used for self-protection, target shooting, sporting, and law enforcement, while tobacco consumption has no comparable positive uses.[214] Whistleblowers and internal memos from the tobacco industry revealed corporate deceit, which weakened the position of the companies, but no comparable items have surfaced in gun litigation battles.[215] Next, gun manufacturers have never tried to hide the fact that guns are designed for deadly uses, while tobacco companies disputed negative health claims about their products for decades.[216] Furthermore, guns have a positive history in our culture, symbolizing freedom, independence, and honor.[217] The Second

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209. *Id.* (quoting Judge Robert McWeeny's opinion).

210. *Id.* (quoting Judge Robert McWeeny's opinion).

211. *Id.* (quoting Judge Robert McWeeny's opinion).

212. *Id.* (quoting Judge Robert McWeeny's opinion).

213. *See* Barrett, *supra* note 187, at A1.

214. *See id.*

215. *See id.*

216. *See id.*

217. *See* Andrew Jay McClurg, *Handguns as Products Unreasonably Dangerous Per Se*, 13 U. ARK. LITTLE ROCK L.J. 599, 613 (1991). He states:

> Our romantic attraction to guns has honorable enough roots. There was a time in this country when guns were a virtual necessity, fulfilling vital needs for early pioneers and settlers. They put food on the table and protected against attack from hostile natives. But that was at least a century ago.

Id. However, Professor McClurg's inference that the passage of time diminishes the importance that guns play in our society may not be entirely true. Such history is all the more reason for some citizens to strive to maintain the freedom to possess a gun as they have over the past one hundred years.

Amendment right "to keep and bear arms"[218] strikes a powerful chord in many Americans, while the products of tobacco companies have never enjoyed such a reputation.

Finances may be the most important consideration for the cities seeking millions of dollars for the reimbursement of public expenses. While cigarette manufacturers have sales of over $45 billion in the United States, gun manufacturers receive only about $1.4 billion in annual sales, a mere three percent of tobacco sales.[219] Therefore, although tobacco companies could afford to sign a $206 billion deal with the states,[220] gun manufacturers may only be able to afford an amount in the range of $6 billion. Split between thirty cities, this figure may barely cover the cities' legal bills.

Additionally, few groups spoke up for smoker's rights, but gun owners harbor no such indifferent attitudes.[221] In fact, the NRA has positioned itself as a very significant player in the conflict by encouraging federal and state legislation which would prohibit lawsuits against the industry.[222] Moreover, the

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218. U.S. CONST. amend. II.

219. *See* Barrett, *supra* note 187, at A1.

220. *See* Mansnerus, *supra* note 188, at D5.

221. *See* Barrett, *supra* note 187, at A1.

222. The NRA was founded in 1871 by former Union Army officers who were concerned that many Northern soldiers could not properly use their weapons. *See* Melissa Ann Jones, *Legislating Gun Control in Light of* Printz v. United States, 32 U.C. DAVIS L. REV. 455, 483 n.4 (1999). The formal views of the NRA include the idea that, "[t]he concept of using lawsuits to destroy a lawful and constitutionally-protected activity violates long-standing American principles." NATIONAL RIFLE ASSOCIATION, FABLES, MYTHS & OTHER TALL TALES ABOUT GUN LAWS, CRIME AND CONSTITUTIONAL RIGHTS 18 (1999). Furthermore, the organization stresses that courts have routinely rejected the allegations that manufacturers should be held liable because they should have known that a criminal could misuse a gun and that guns are socially unacceptable products whose risk outweighs their social utility. The organization quotes the decision of *Eichstedt v. Lakefield Arms Ltd.*, 849 F. Supp. 1287, 1293 (E.D. Wis. 1994), where the court said, "[o]ne should never point a gun at another, thinking it is unloaded. And one should never compound the felony by pulling the trigger. When these cardinal rules are violated, the victim has an airtight negligence suit against the shooter. He has no case against the gun maker." *Id.*

The NRA is not the only source for legislation discouraging gun suits. Some states have taken steps to see that the responsibility remains with the person, not the manufacturer of the product, and they already have forms of such statutes. *See* Bumann, *supra* note 44, at 732. For example, Maryland's commercial code states:

> A person or entity may not be held strictly liable for damages of any kind resulting from injuries to another person sustained as a result of the criminal use of any firearm by a third person, unless the person or entity conspired with the third person to commit, or willfully aided, abetted, or caused the commission of the criminal act in which the firearm was used.

MD. CODE art. 27, § 36-I9(h) (2000). California, Colorado, Idaho, Montana, Texas, North Carolina, and Washington have also enacted some form of gun control laws with restrictions on plaintiffs. *See* Bumann, *supra* note 44, at 732.

fractured make-up of the gun industry may prevent any consensus among the companies, unlike the brokered deal secured against all the major tobacco companies.[223] In fact, the gun industry is composed of dozens of small, mainly privately held companies that expressed a variety of reactions to the litigation.[224] The diversity present in the gun industry is also illustrated by the manufacturers' wide variety of products, which is unlike the situation among tobacco companies.[225] This lack of homogeneity will make obtaining an industry-wide agreement a tough battle. Some of the better-established companies that make higher-quality guns for hunters, competitive shooters, and law enforcement officials are reluctant to be associated with the companies that make the cheaper, smaller, more concealable guns that are often used in crimes.[226] Still, other manufacturers want to try to shift the responsibility to the retailers.[227] These differences highlight why cities face significant obstacles in their lawsuits and negotiations.

However, if the cities can focus on reforming the practices of the industry, instead of going after large financial settlements, they might be able to strike a deal with some of the manufacturers.[228] To most effectively tackle problems of gun violence, the cities should concentrate on forcing the industry to improve their safety devices. Specifically, installing locking technology to prevent unauthorized access and misuse could prevent thousands of tragedies, especially among children.[229] In addition, requiring tighter controls over the industry's distribution channels would drastically decrease illegal trafficking while eradicating a major source of guns for criminals and juveniles.

C. *National Influence*

In mid-December 1999, the federal government added some weight to the suits already filed by the municipalities by pledging to file a large class-action lawsuit against the industry unless the companies agree to change their business practices.[230] The goal of the administration was to encourage negotiations between the two groups, but the White House discussed the organization of a lawsuit among approximately 3300 public housing authorities, which would have alleged that the industry designs unsafe products and knowingly distributes them to criminals.[231] However, the political landscape of the gun debate completely

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223. *See* Barrett, *supra* note 187, at A1.

224. *See* Paul M. Barrett, *Courting Trouble? As Lawsuits Loom, Gun Industry Presents a Fragmented Front*, WALL ST. J., Dec. 9, 1998, at A1.

225. *See* Barrett, *supra* note 187, at A1.

226. *See* Barrett, *supra* note 224, at A1.

227. *See id.*

228. *See* Siebel, *supra* note 12, at 289.

229. *See id.* at 289-90.

230. *See* Bai, *supra* note 131, at 38.

231. *See id.* However, some government officials were concerned that the White House would rush to strike a deal with the industry in order to claim a political victory before the November 2000

changed with President Bush was inaugurated in January 2001. Considered a strong ally of the NRA, Bush eliminated the possibility of a federal lawsuit or any pressure from the federal government on the gun industry.[232] In fact, Bush pledged to back federal legislation that would prohibit cities from suing gun manufacturers, similar to the state legislation he helped push through as governor of Texas.[233] Although Bush does support instituting background checks at gun shows, a major issue in the debate, he does so only with the caveat that such checks be instantaneous, while opponents contest that three days is a more reasonable time period.[234]

While the clash over guns continues, it is clear that anti-gun groups have lost an ally in the Executive Branch, but the impact that this change in power will have on the gun debate remains to be seen. As between a compromise and courtroom victories, a compromise among the gun manufacturers and the cities is more likely. However, a long fight still looms ahead and monetary damages will be nearly impossible to achieve in a suit against gun makers when considering the involvement and strength of the NRA and the differences between the tobacco and gun industries. Consequently, individual plaintiffs and the cities have very little chance of winning damages in any court, and the prospects for a broadly successful negotiation are also small. As a result, the clear response to the question of whether *Hamilton* is a good predictor of what the future holds for gun manufacturers is an unambiguous no.

CONCLUSION

The prevalence of handguns in society, the notoriety of public shootings, and the ease of going to court, have led victims and anti-gun supporters to join the litigation fray. However, successful courtroom battles will remain out of reach for plaintiffs. The consistent failure of suits against gun manufacturers shows the unwillingness of judges to impose such severe liability on a lawfully made, properly functioning product. It is highly unlikely that one verdict could overturn such strong precedent. The lax distribution methods of some manufacturers may have convinced one jury that a number of gun companies need to tighten up their relationships with distributors and retailers, but this does not illustrate the viability of widespread liability.[235] The *Hamilton* verdict may have provided a

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election. *See* Paul M. Barrett & Shailagh Murray, *Some Plaintiffs Fear Clinton's Role in Gun Suits*, WALL ST. J., Dec. 15, 1999, at A16. Although some cities were willing to work with the President's team, others refused to meet because the administration was not pursuing the goals in which their city was interested. *See id.*

232. *See* Ben White & Terry M. Neal, *Bush Plans Gun Lock Giveaway; Governor Envisions Expanding Texas Program Nationwide*, WASH. POST, May 13, 2000, at A10.

233. *See id.*

234. *See id.*

235. The *Patterson* court predicted that if a defective distribution theory was adopted, a jury may be able to conclude that a car dealer who indiscriminately sold a car to a non-minor with enough money to buy the product was a defective method of distribution; therefore, manufacturers

wake-up call to those manufacturers, but the reluctance of the jury to assess damages for any of the deceased victims is symbolic. This verdict was not a preview of future success in gun litigation; it was an erratic decision, made specific to the facts and circumstances at the time, and it would be nearly impossible to repeat. For these reasons, along with the uniqueness of Judge Weinstein's courtroom, this verdict will provide no momentum for plaintiffs across the country.

In addition, the suits filed by the municipalities will not reap comparable financial awards to the tobacco negotiations. Gun manufacturers do not possess the cash reserves available to tobacco companies and the gun industry is so segregated that presenting a unified front will be extremely problematic. The influence of pro-gun groups is also a component not to be underestimated. There is a powerful force of gun owners and Second Amendment supporters that will fight hard to overcome any possible regulation. The NRA certainly proved their strength as well by helping to get state legislation passed which makes it illegal for a municipality to sue a gun manufacturer. If tobacco companies had enjoyed similar support, there may not be any settlements today. Any possible outcome of the cities' suits will more likely encompass limited restrictions on industry practices than actual monetary damages from legal liability.

Finally, our society is not ready, nor should it be ready, to impose such drastic legal liability on an acceptable product. Holding a manufacturer liable for a product regardless of the intervening act of a criminal is beyond the realm of products liability.[236] Helping to compel stricter background checks for purchases at gun shows is one issue, but pursuing the goal of earning a verdict worth millions of dollars for the expenses of crime is too far removed from acceptable causal connections. The ramifications of this level of liability would lead plaintiffs to try to topple other industries in court, creating a domino effect. With every dangerous product sold legitimately there are public policy choices that must be made that balance the costs and benefits of the product. In the realm of guns, the choice was made a very long time ago, and instituting such drastic legal changes now should be left to the democratic process. Courts are not well-equipped to handle problems of handgun abuse because they decide individual cases on the basis of evidentiary records; thus, they cannot monitor the effects of their decisions or make alterations when needed.[237] Each factfinder also brings a different set of values to the case which leads to the inevitable result that decisions in gun suits will vary widely and provide little or no guidance to manufacturers.[238] Furthermore, asking a jury to balance the potential for reduced violence against the strong desire of many citizens to own handguns is too momentous of a decision for twelve laypersons.

Finally, the emotional level of the debate over handguns suggests that people

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should compensate all victims of automobile accidents. *See* Patterson v. Rohn Gesellschaft, 608 F. Supp. 1206, 1215 n.27 (N.D. Tex. 1985).

236. *See* Bumann, *supra* note 44, at 735-36.

237. *See* Note, *supra* note 127, at 1925.

238. *See id.*

favor or oppose gun control not because of the impact that new regulations may have on society, but because of their own opinions about the role that guns should play in the United States.[239] This analysis illustrates why the courtroom is not the place for legislating. If changes are made at all, they should come in incremental steps through the legislative and executive branches because gun control is an issue that implicates the personality of our society and the goals of our country.[240]

239. *See id.*
240. *See id.*

STANDING TO APPEAL: SHOULD OBJECTING SHAREHOLDERS BE ALLOWED TO APPEAL ACCEPTANCE OF A SETTLEMENT?

KENNETH J. MUNSON*

INTRODUCTION

Derivative actions have long permitted shareholders to exercise some control over wayward management not acting in the best interest of the corporation.[1] Concern developed over abuse of the derivative action by plaintiffs' attorneys through strike suits[2] designed to bilk money out of corporations using the threat of lawsuits to create settlement value.[3] In response to the growing use of strike suits, provisions in the Federal Rules of Civil Procedure were designed to encourage shareholders to raise objections prior to the dismissal or acceptance of a settlement of a derivative action by a district court to help police attorneys not acting in the shareholders' best interest.[4] Recently, the federal circuits have split regarding whether such a shareholder, who appears before the court to object to the proffered settlement, has standing to appeal the acceptance of a settlement.[5]

However, after accepting certiorari on the topic[6] and hearing *California Public Employees Retirement System v. Felzen*,[7] an equally divided U.S. Supreme Court affirmed the Seventh Circuit's decision without opinion, effectively providing no answer for the lower courts.[8] Depending upon the jurisdiction in which a corporation resides, shareholders are currently faced with different standards of involvement in the district courts. If shareholders want to police potentially collusive settlements in derivative actions, intervention is the only

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1. *See* Hawes v. City of Oakland, 104 U.S. 450 (1881). The court gives a history of the development of the doctrine beginning with early English cases. *See id.* at 454-60.

2. Strike suits are defined as "[a] suit (esp[ecially] a derivative action), often based on no valid claim, brought either for nuisance value or as leverage to obtain a favorable or inflated settlement." BLACK'S LAW DICTIONARY 1448 (7th ed. 1999).

3. *See* RALPH C. FERRARA ET AL., SHAREHOLDER DERIVATIVE LITIGATION: BESIEGING THE BOARD § 1.03 (6th ed. 2000). In response to fear of strike suits, states began enacting security-for-expense statutes. As an additional protection for corporations, the Federal Rules of Civil Procedure included provisions requiring notice to shareholders affording an opportunity to object to collusive settlements. *See infra* Part I.

4. *See* FED. R. CIV. P. 23.1.

5. *See* Felzen v. Andreas, 134 F.3d 873, 878 (7th Cir. 1998) (noting the creation of a conflict between the circuits), *aff'd per curiam sub nom. by an equally divided Court* Cal. Pub. Employees' Ret. Sys. v. Felzen, 525 U.S. 315 (1999).

6. *See id.*

7. *Cal. Pub. Employees' Ret. Sys.*, 525 U.S. at 315.

8. *See id.*

means to preserve appellate review in the Seventh Circuit; whereas appearance at the settlement hearing to formally object is adequate involvement to supply appellate standing in the Second and Third Circuits.

Part I of this Note will provide a brief overview of the history and development of the derivative action, from its origin as an equitable action through its incorporation into the Federal Rules of Civil Procedure. Part II will discuss the development of the split between the circuits regarding the requirement of intervention (or lack thereof) in order to appeal a settlement of a derivative action. Next, Part III will discuss the advantages and disadvantages of requiring intervention to gain standing to appeal. Part IV of this Note will then discuss the advantages and disadvantages of only requiring involvement as an objector to a settlement to gain standing to appeal acceptance of the settlement. Finally, Part V of this Note will conclude that the U.S. Supreme Court should require intervention to remain consistent with its prior holdings and allow *any* divergence from this rule only through amendment to the Federal Rules of Civil Procedure.

I. History of the Derivative Action

A. Development of the Derivative Action as an Equitable Action

The Supreme Court recognized the derivative suit as an equitable cause of action in *Dodge v. Woolsey* in 1855.[9]

> It is now no longer doubted, either in England or the United States, that courts of equity, in both, have a jurisdiction over corporations, at the instance of one or more of their members . . . to prevent any misapplication of their capitals or profits, which might result in lessening the dividends of stockholders . . . if the acts intended to be done create what is in the law denominated a breach of trust.[10]

The purpose of the derivative action is to give shareholders a means to protect the corporation from the "misfeasance and malfeasance of 'faithless directors and managers.'"[11] A shareholder's derivative suit is an equitable action developed to address an inadequate remedy at law regarding a shareholder's ability to redress a breach of duty owed to the corporation by its managers.[12]

Subsequent to *Dodge*, the Court set forth procedural and substantive requirements a plaintiff shareholder must meet to be entitled to initiate a derivative action in *Hawes v. City of Oakland*.[13] Procedurally, the Court required a shareholder to exhaust all means within the corporation to remedy the

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9. 59 U.S. (18 How.) 331 (1855).

10. *Id.* at 341.

11. Kamen v. Kemper Fin. Servs., Inc., 500 U.S. 90, 95 (1991) (quoting Cohen v. Beneficial Loan Corp., 337 U.S. 541, 548 (1949)).

12. *See* Koster v. (Am.) Lumbermens Mut. Cas. Co., 330 U.S. 518, 522 (1947).

13. Hawes v. City of Oakland, 104 U.S. 450, 460-61 (1881).

grievance.[14] In addition, a shareholder had to address the grievance with other shareholders as a body, time permitting.[15] Substantively, the Court suggested various types of grievances meant to be addressed by a derivative action: (1) an action by the board beyond its authority as conferred by the charter of the corporation, (2) a fraudulent transaction by the acting managers, (3) a board of directors who has acted in their own interests, or (4) a majority of shareholders that are "oppressively and illegally" acting through the corporation "in violation of the rights of other shareholders."[16]

In 1882 the Court adopted Equity Rule 94, which effectively codified the requirements of *Hawes*.[17] Equity Rule 94 was later recodified as Equity Rule 27 and then as Federal Rule of Civil Procedure 23(b) under the class action category.[18] Finally, derivative actions were separated from class actions with the adoption of Federal Rule of Civil Procedure 23.1, which remains substantially in the same form today as when it was enacted in 1966.[19]

Derivative actions have been championed for protecting shareholders' interests in corporations in two ways. First, derivative actions provide shareholders a means to recover monetary or non-monetary benefits for the

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14. *See id.*

15. *See id.* at 461.

16. *Id.* at 460.

17. *See* FERRARA ET AL., *supra* note 3, § 1.03.

18. *See id.*; *see also* 5 JAMES WM. MOORE ET AL., MOORE'S FEDERAL PRACTICE ¶ 23.1 app. 100 (3d ed. 2000) (noting that when Rule 23 for class actions was rewritten, Rule 23.1 was added as a separate rule). The 1966 revision was the only substantive change to the rules for derivative actions since their original codification in Rule 23(b) in 1937. *See id.*

19. *See* FED. R. CIV. P. 23.1:

> In a derivative action brought by one or more shareholders or members to enforce a right of a corporation or of an unincorporated association, the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint shall be verified and shall allege (1) that the plaintiff was a shareholder or member at the time of the transaction of which the plaintiff complains or that the plaintiff's share or membership thereafter devolved on the plaintiff by operation of law, and (2) that the action is not a collusive one to confer jurisdiction on a court of the United States which it would not otherwise have. The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for the plaintiff's failure to obtain the action or for not making the effort. The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association. The action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to shareholders or members in such manner as the court directs.

Id.

corporation.[20] Second, the threat of a derivative suit provides value to a corporation by deterring managers and directors of a corporation from acting against the corporation's best interests.[21] However, the usefulness of derivative suits has been questioned due to increases in accountability of corporate management. Advances have been achieved through: (1) a shift toward independent boards of directors, (2) improvements in corporate governance standards and compliance, and (3) the existence of market forces such as increased activity in mergers and hostile takeovers.[22] Thus, due to increased confidence in the ability of corporations to act in the best interests of shareholders, reliance on derivative actions for the protection of shareholders is lessened.

B. Recognizing Abuses of Derivative Actions by Attorneys

Throughout the history of derivative actions, courts have been concerned with the potential for strike suits, in which a plaintiff's attorney brings an action with the intention of extracting payment from the corporation simply for the nuisance value of the suit.[23] Due to the nature of a derivative action, commentators generally agree with courts that an unusual potential exists for opposing parties to settle on terms that are not in the corporation's best interest.[24] In response to the development of strike suits, states began to enact security-for-expense statutes, which require a plaintiff to post security for a defendant's expenses if the action is deemed to be without merit.[25] Some commentators believed that the security-for-expense statutes would put an end to derivative actions; however, the causes survive as plaintiffs tailor their pleadings to avoid such statutes.[26] As a federal response to the potential for abusive suits, Civil

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20. *See* FERRARA ET AL., *supra* note 3, § 14.05.

21. *See* Reinier Kraakman et al., *When Are Shareholder Suits in Shareholder Interests?*, 82 GEO. L.J. 1733, 1736 (1994).

22. *See* John C. Coffee, Jr., *The Unfaithful Champion: The Plaintiff as Monitor in Shareholder Litigation*, 48 LAW & CONTEMP. PROBS. 5, 7 (1985).

23. *See* FERRARA ET AL., *supra* note 3, § 1.03 (noting an infamous plaintiff that had initiated nineteen suits and earned the nickname "Sue and Settle" Venner).

24. *See* Bell Atl. Corp. v. Bolger, 2 F.3d 1304, 1309 n.8 (3d Cir. 1993) (citing Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. CHI. L. REV. 1, 3 (1991); Ralph K. Winter, *Paying Lawyers, Empowering Prosecutors, and Protecting Managers: Raising the Cost of Capital in America*, 42 DUKE L.J. 945, 948 (1993)); *see also* Coffee, *supra* note 22, at 12 (suggesting that the derivative action as it exists today minimizes the possibility of substantial corporate recovery and maintains the likelihood of costly litigation, both factors leading to greater likelihood of settlement without benefit to the corporation); Kraakman et al., *supra* note 21, at 1740-43 (finding that shareholder incentives to bring and maintain a suit are often poorly aligned with the interests of the corporation).

25. *See* FERRARA ET AL., *supra* note 3, § 1.03.

26. *See id.*

Procedure Rule 23.1 was enacted in 1966 (Rule 23.1), which provides two new aspects to derivative actions: (1) plaintiff shareholders who desire to settle or dismiss the action must receive court approval and give notice to the other shareholders, and (2) plaintiff shareholders must represent the interests of the other shareholders fairly and adequately.[27]

Several explanations have been proposed for why a derivative action is such a fertile ground for attorneys to abuse the legal process by extracting fees from a corporation. One aspect of a derivative suit is that if the suit is settled, the corporation pays the legal fees of both parties.[28] The fee structure for a derivative suit has been described as a cross between the American Rule, under which each party is required to pay his own fee, and the English Rule, under which the losing party pays the winning party's fees.[29] This hybrid fee structure exists because the plaintiff can shift his costs to the corporation, while the defendant may be able to shift his costs to the plaintiff only if the jurisdiction requires a security-for-expense bond.[30] That the plaintiff might have to pay the defendant's legal costs increases the plaintiff's risk if the action is litigated to judgment, thereby increasing the plaintiff's incentive to settle.[31] Likewise, the defendant to a derivative action has an incentive to settle because he will be indemnified by the corporation and his insurer(s) will cover a settlement. Whereas, if the action is adjudicated and the defendant is held liable to the corporation, statutes will usually preclude indemnification by the corporation.[32]

Another reason that the settlement of derivative suits presents such a high risk of collusion is that often the plaintiff shareholder is not significantly involved in the litigation and the attorney is usually directing the litigation.[33] Because the plaintiff shareholder may not have much at stake in the litigation, the plaintiff's attorney may not be closely monitored.[34]

> One of the risks flowing from shareholders' difficulty in monitoring derivative litigation is that plaintiffs' counsel and the defendants will structure a settlement such that the plaintiffs' attorneys' fees are disproportionate to any relief obtained for the corporation. Plaintiffs' attorneys and the defendants may settle in a manner adverse to the interests of the plaintiffs by exchanging a low settlement for high fees.[35]

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27. *See* FED. R. CIV. P. 23.1; *see also* 5 MOORE ET AL., *supra* note 18, ¶ 23.1 app. 02, at 6 (illustrating the change from old Rule 23(b) to new Rule 23.1).

28. *See* Coffee, *supra* note 22, at 15-16.

29. *See id.*

30. *See id.*

31. *See id.* at 23.

32. *See id.* at 23-24.

33. *See* FERRARA ET AL., *supra* note 3, § 14.05 ("[D]erivative litigation is unusual in that the party primarily responsible for prosecuting the action is not the real party in interest—the corporation—or even the nominal plaintiff shareholder, but rather is the plaintiff's counsel.").

34. *See id.*

35. Bell Atl. Corp. v. Bolger, 2 F.3d 1304, 1310 (3d Cir. 1993).

An additional area of concern is the high rate of settlements compared to the relatively few number of litigated victories by plaintiffs' attorneys.[36] It is generally expected that litigated outcomes should split almost equally between plaintiffs and defendants' victories.[37] However, in the derivative suit arena, federal courts find for the defendant by an overwhelming ratio.[38] The conclusion can be drawn that most derivative actions lack merit and are brought merely for their settlement value.[39] Thus, empirical evidence supports the perceived need to police settlements.

As a method to police collusive actions, nonparty shareholders have used their right to present objections at settlement hearings pursuant to Rule 23.1 to challenge attorneys' fees.[40] One important and necessary aspect of the viability of derivative actions is the ability of the plaintiff's attorney to recover his fees from the corporation.[41] Therefore, a logical way to attack the viability of derivative actions is to attack their funding. If attorneys fear they will not receive compensation, they will be less likely to bring the action at all.

Logically, the best people to police settlements of lawsuits are those who have an investment at stake. Standing to object to the settlement of derivative action is limited. Most jurisdictions agree that a shareholder must own shares in the corporation at the time of the settlement to have standing to present objections, although some jurisdictions require ownership only at the time of the wrongdoing.[42] It is the degree to which a shareholder must become involved in the underlying action that separates the Seventh Circuit from the other circuits that have defined the requirement in the context of the derivative action.

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36. *See* Coffee, *supra* note 22, at 9.

37. *See id.*

38. *See id.*

39. *See* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 742-43 (1975).

> [T]he mere existence of an unresolved lawsuit has settlement value to the plaintiff not only because of the possibility that he may prevail on the merits, . . . but [also] because of the threat of extensive discovery and disruption of normal business activities which may accompany a lawsuit which is groundless in any event . . . .

Id.

40. *See* Kaplan v. Rand, 192 F.3d 60 (2d Cir. 1999); Felzen v. Andreas, 134 F.3d 873 (7th Cir. 1998), *aff'd per curiam sub nom. by an equally divided Court* Cal. Pub. Employees' Ret. Sys. v. Felzer, 525 U.S. 315 (1999); Rosenbaum v. MacAllister, 64 F.3d 1439 (10th Cir. 1995). In all three cases, an objecting shareholder challenged the fee portion of the settlement.

41. *See* 7C CHARLES ALAN WRIGHT ET AL., FEDERAL PRACTICE AND PROCEDURE: FEDERAL RULES OF CIVIL PROCEDURE § 1841 (2d ed. 1986) (noting that justifications for reimbursement of attorney fees include the encouragement of bringing the suit by shareholders where monetary interests at stake are small relative to the cost of litigation and the enrichment theory, whereby the corporation whose assets are increased as a result of the suit on its behalf should bear the costs associated with the benefits derived).

42. *See* FERRARA, ET AL., *supra* note 3, § 14.04.

II. Development of the Split over Level of Shareholder Involvement Required to Gain Appellate Standing

Prior to 1998, the circuits had not definitively addressed the different standards applicable to derivative and class action intervention requirements to have standing to appeal.[43] Courts that required intervention to maintain standing to appeal did so in the class action setting, not in the derivative action setting.[44] However, in 1998 the Seventh Circuit issued its decision requiring Federal Civil Procedure Rule 24 intervention[45] specifically in the derivative action context.[46]

A. Requirement of Formal Intervention to Provide Party Status to Appeal Acceptance of Settlement over Shareholder Objections

In 1998 the Seventh Circuit, in *Felzen v. Andreas*,[47] ruled that a shareholder who appeared at a settlement hearing and objected to a proposed settlement of a derivative action, but did not formally intervene, did not have standing to appeal the district court's acceptance of the settlement.[48] The Supreme Court granted certiorari and affirmed the Seventh Circuit's decision in a four-four decision without comment.[49] Thus, the Supreme Court did nothing to clarify the confusion in the lower courts.

The derivative suit in *Felzen* was an attempt to recover from the directors of Archer Daniels Midland (ADM) some of a $100 million fine for criminal antitrust charges and payment of a $90 million settlement of antitrust lawsuits filed against ADM for engaging in a price fixing scheme.[50] A settlement was reached in the derivative action, under which the directors agreed to pay $8 million to the corporation, with $3.92 million awarded to plaintiff's counsel.[51] California Public Employees' Retirement System (CalPERS), a substantial shareholder, submitted objections to the district court and appeared at the

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43. *See Rosenbaum*, 64 F.3d at 1439; Bell Atl. Corp. v. Bolger, 2 F.3d 1304 (3d Cir. 1993).

44. *See* Loran v. Furr's/Bishop's Inc., 988 F.2d 554 (5th Cir. 1993); Croyden Assocs. v. Alleco, Inc., 969 F.2d 675 (8th Cir. 1992); Guthrie v. Evans, 815 F.2d 626 (11th Cir. 1987).

45. FED. R. CIV. P. 24(b) states, in pertinent part,

> [u]pon timely application anyone may be permitted to intervene in an action: . . . (2) when an applicant's claim or defense and the main action have a question of law or fact in common. . . . In exercising its discretion the court shall consider whether the intervention will unduly delay or prejudice the adjudication of the rights of the original parties.

46. *See* Felzen v. Andreas, 134 F.3d 873 (7th Cir. 1998), *aff'd per curiam sub nom. by an equally divided Court* Cal. Pub. Employees' Ret, Sys. v. Felzer, 525 U.S. 315 (1999).

47. *Id.*

48. *See id.*

49. *See Cal. Pub. Employees' Ret. Sys.*, 525 U.S. at 315.

50. *See* Petitioner's Brief at 2-3, Cal. Pub. Employees' Ret. Sys. v. Felzen, 525 U.S. 315 (1999) (per curiam) (No. 97-1732).

51. *See id.* at 8-9.

settlement hearing, but the court approved the settlement over CalPERS objections.[52] CalPERS then appealed the court's approval of the settlement to the Seventh Circuit Court of Appeals.[53]

The Seventh Circuit determined that CalPERS lacked standing to appeal the approval of the settlement.[54] The court rested its opinion largely upon *Marino v. Ortiz*.[55] In *Marino*, the Supreme Court determined that a group of white police officers who were not parties to an agreement settling a class action discrimination lawsuit could not appeal from the consent decree approving the settlement.[56] In issuing its decision, the Court stated that "because petitioners were not parties to the underlying lawsuit, and because they failed to intervene for purposes of appeal, they may not appeal from the consent decree approving that lawsuit's settlement."[57]

In *Felzen*, the court began its opinion by quoting *Marino*, stating that "[t]he rule that only parties to a lawsuit, or those that properly become parties, may appeal an adverse judgment, is well settled."[58] The court pointed out that prior to *Felzen* it had determined that a class member who was a nonparty did not have standing to appeal from a summary judgment order.[59] The *Felzen* court based its decision on *Marino*, and in doing so, implicitly overruled circuit precedent.[60] The court noted that although class actions and derivative actions have distinctive characteristics, *Marino* applies to both situations.[61] Therefore, despite the concern that "derivative actions do little to promote sound management and often hurt the firm by diverting the managers' time from running the business while diverting the firm's resources to the plaintiffs' lawyers without providing a corresponding benefit," the court was prevented from hearing this argument on appeal because CalPERS was not a party to the litigation in the district court.[62]

The *Felzen* court also based its decision on the unique status of a shareholder in derivative litigation.[63] According to the court, injury to a shareholder does not create party status for a shareholder because it is not a shareholder's injury that

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52. *See id.* at 8.

53. *See id.* at 9.

54. *See* Felzen v. Andreas, 134 F.3d 873 (7th Cir. 1998), *aff'd per curiam sub nom. by an equally divided Court* Cal. Pub. Employees' Ret. Sys. v. Felzen, 525 U.S. 315 (1999).

55. 484 U.S. 301 (1988) (per curiam), *aff'g per curiam* Hisp. Soc'y of N.Y. City Police Dep't, Inc. v. N.Y. City Police Dep't, 806 F.2d 1147 (2d Cir. 1986).

56. *See id.* at 303-04.

57. *Id.* at 304.

58. *Felzen*, 134 F.3d at 874 (quoting *Marino*, 484 U.S. at 304).

59. *See id.* (citing *In re* Brand Name Prescription Drugs Antitrust Litig., 115 F.3d 456 (7th Cir. 1997)).

60. *See id.* (citing Tryforos v. Icarian Dev. Co., 518 F.2d 1258 (7th Cir. 1975) (suggesting nonparty shareholders could appeal)).

61. *See id.* at 878.

62. *Id.* at 876.

63. *See id.* at 875.

is being litigated.[64] Rather, the corporation's injury is the subject of the litigation.[65] The court reasoned that a shareholder who places his trust in the acting managers of the corporation has no more right to appeal the settlement of a derivative action than a shareholder has to appeal a settlement of antitrust litigation entered into by management on behalf of a corporation.[66]

B. Objection to Settlement Without Intervention Sufficient to Provide Party Status

Two circuits have specifically determined that, in the derivative action context, a shareholder need not formally intervene to have standing to appeal the acceptance of a settlement.[67] *Kaplan v. Rand*,[68] decided after *Felzen*, specifically rejected the *Felzen* court's reasoning.[69] The *Kaplan* court determined that because *Felzen* was affirmed by an equally divided Supreme Court, the Court had not rejected the rule that allows a nonparty to appeal a judgment.[70] As such, the *Kaplan* court determined that the nonparty shareholder objector in this case had standing to appeal the lower court's judgment because the shareholder had an interest that was affected by the judgment.[71]

The appeal in *Kaplan* originated from a derivative suit filed on behalf of Texaco to recover from its directors part of the $115 million in costs paid by the corporation to settle a discrimination claim filed against Texaco.[72] The settlement required inclusion of a statement in Texaco's Annual Report to shareholders notifying them of the right to request certain portions of a task force report prepared pursuant to the discrimination settlement. The settlement also required incorporation of a non-discrimination statement in future contracts entered into with outside vendors.[73] In addition, the plaintiff's attorney requested up to $1.4 million in attorney fees.[74] The district court approved the settlement as "fair and reasonable" and a Special Master, who was appointed to inquire into the appropriateness of the attorney fees, determined that fees of $1 million were appropriate.[75] The district court approved the Special Master's report, and

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64. *See id.* at 876.

65. *See id.*

66. *See id.* at 875.

67. *See* Kaplan v. Rand, 192 F.3d 60 (2d Cir. 1999); Bell Atl. Corp. v. Bolger, 2 F.3d 1304 (3d Cir. 1993).

68. *Kaplan*, 192 F.3d at 60.

69. *See id.* at 68.

70. *See id.* (finding judgment affirmed by an equally divided court does not have precedential effect) (citing Rutledge v. United States, 517 U.S. 292, 304 (1996)).

71. *See id.* at 67.

72. *See id.* at 61-62.

73. *See id.* at 64.

74. *See id.*

75. *See id.* at 66.

rejected objections raised by nonparty shareholders.[76]

Kaplan is interesting because it was the Second Circuit that issued the opinion that was reviewed by the Supreme Court in *Marino*.[77] The Second Circuit in *Kaplan* interpreted *Marino* much less restrictively than did the Seventh Circuit in *Felzen* regarding the right of a nonparty to appeal. The *Kaplan* court looked favorably upon the following Court statement:

> The rule that only parties to a lawsuit, or those that properly become parties, may appeal an adverse judgment, is well settled. The Court of Appeals suggested that there may be exceptions to this general rule, primarily "when the nonparty has an interest that is affected by the trial court's judgment." We think the better practice is for such a nonparty to seek intervention for the purposes of appeal; denials of such motions are, of course, appealable.[78]

The *Kaplan* court noted that by declaring intervention as "the better practice," the Supreme Court did not necessarily require intervention, leaving the door open for exceptions to the general rule, such as the affected-interest exception advanced in *Kaplan*.[79]

When reviewing the affected-interest doctrine's history, the *Kaplan* court referred to a statement by Judge Learned Hand "[i]f not a party, the putative appellant is not concluded by [a judgment], and is not therefore aggrieved by it. But if the decree affects his interests, he is often allowed to appeal."[80] The court determined that because the settlement of the derivative action directed the corporation to pay the attorney fees, the stockholders' interests were affected through the financial well being of the corporation.[81] Even though the corporation's insurance company was to pay the attorney fees and the premiums did not increase upon renewal, the court determined that the possibility that the premiums could have lowered or could rise in the future, along with discouraging future lawsuits, was enough to give the shareholders an affected interest.[82]

The court also advanced the position that allowing appellate review would promote a policy of fairness to shareholders.[83] The adversarial process tests the settlement's fairness, and the court felt "[i]t would make little sense to invite a shareholder to file objections in the manner provided by Rule 23.1 and then deny him the right to challenge the district court's ruling on his objection."[84] When

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76. *See id.*

77. *See* Hispanic Soc'y of N.Y. City Police Dep't, Inc. v. N.Y. City Police Dep't, 806 F.2d 1147 (2d Cir. 1986), *aff'd sub nom.* Marino v. Ortiz, 484 U.S. 301 (1988).

78. *Kaplan*, 192 F.3d at 68 (quoting *Marino*, 484 U.S. at 304 (internal citations omitted)).

79. *See id.*

80. *Id.* at 66-67 (quoting West v. Radio-Keith-Orpheum Corp., 70 F.2d 621, 624 (2d Cir. 1934)).

81. *See id.* at 67.

82. *See id.* at 68.

83. *See id.* at 67.

84. *Id.*

discussing the fairness of the settlement, the court noted the concern that when the interests of the plaintiff's attorney and the defendants become aligned toward settlement, the district court may overlook their "mutual indulgence."[85]

When addressing this concern over collusive settlements, the court looked to the Third Circuit's decision in *Bell Atlantic Corp. v. Bolger*.[86] In that case, the Third Circuit acknowledged the general rule stated in *Marino*,[87] but determined that whether an objector in derivative and class action settings may appeal remained unsettled despite *Marino*.[88] The court noted the "agency costs" associated with derivative suits, where shareholders often "lack the incentive and information to police settlements—the costs of policing typically outweigh any pro rata benefits to the shareholder."[89] The court stressed the potential for plaintiffs' attorneys and defendants to exchange a low settlement for high fees due to lack of proper monitoring by shareholders.[90] Finally, the court concluded that "[a]ssuring fair and adequate settlements outweighs concerns that non-intervening objectors will render the representative litigation 'unwieldy.'"[91]

III. ADVANTAGES AND DISADVANTAGES OF AN INTERVENTION REQUIREMENT TO GAIN PARTY STATUS FOR THE OBJECTOR

A. Advantages of an Intervention Requirement

The Seventh Circuit's view has generally been regarded as an approach that places too much emphasis on efficiency in litigation, while placing too little emphasis on policing collusive settlements between the plaintiff's attorney and defendants.[92] Perhaps the most advantageous aspect of requiring intervention is

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85. *Id.* (citation omitted).

86. 2 F.3d 1304, 1307 (3d Cir. 1993).

87. *See id.*

88. *See id.* The court noted, "[a] member of the class who appears in response to the court's notices given to pursuant to the Rule [23.1], and objects to the dismissal or compromise has a right to appeal from an adverse final judgment although he did not become a formal party of record." *Id.* (quoting 3B JAMES W. MOORE, MOORE'S FEDERAL PRACTICE ¶ 23.1.24[3] (1993)). *See* 7C WRIGHT ET AL., *supra* note 41, § 1839, at 182 ("An objector to the settlement may appeal the court's approval of the compromise."). *But see* 15A CHARLES ALAN WRIGHT ET AL., FEDERAL PRACTICE AND PROCEDURE: JURISDICTION AND RELATED MATTERS, § 3902.1, at 105-06 (2d ed. 1992) ("[I]t has been ruled that an individual class member who has not been recognized as a class representative and who has not intervened lacks standing to appeal a judgment on the merits. Similar rules may apply to corporate shareholders affected by the judgment in a derivative action.").

89. *Bell Atl. Corp.*, 2 F.3d at 1309.

90. *See id.* at 1310 n.10 (citing RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW § 21.9, at 570 (4th ed. 1992)).

91. *Id.* at 1310.

92. *See generally* Susanna M. Kim, *Conflicting Ideologies of Group Litigation: Who May Challenge Settlements in Class Actions and Derivative Suits?*, 66 TENN. L. REV. 81 (1998); Rory Zack Fazendeiro, Comment, Felzen v. Andreas*: The Seventh Circuit Shuts Its Doors to Derivative-*

the ability of the parties to better control and contain the costs of an already complex and costly form of litigation.[93] Allowing the extension of a suit that would have otherwise terminated were it not for an appeal by a nonparty would inevitably add to the cost of the underlying litigation.

Moreover, settlements are highly favored in the law as a way of clearing crowded court dockets and ending costly litigation.[94] Extending the lawsuit increases the litigation costs of the corporation, which ultimately pays for both the plaintiff and defendant's legal fees. The derivative suit context is unique in that often the party defending the suit has its legal fees indemnified by the corporation through directors and officers' liability insurance purchased and maintained by the corporation.[95] In addition to the monetary costs incurred by the corporation, the corporation also incurs substantial costs in the time and effort that management devotes to the litigation.[96] Finally, allowing the nonparty to drag the corporation into an unwanted appellate process creates additional cost concerns due to the difficult standard that must be overcome to overturn the settlement and to thus justify the costs of appeal.[97]

Requiring intervention to gain appellate standing is also more true to the nature of a derivative action.[98] A derivative action is designed to make the

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Suit Appeals by Unnamed Shareholders, 4 ROGER WILLIAMS U. L. REV. 533 (1999); Cecilia Lacey O'Connell, Comment, *The Role of the Objector and the Current Circuit Court Confusion Regarding Federal Rule of Civil Procedure 23.1: Should Non-Named Shareholders Be Permitted to Appeal Adverse Judgments?*, 48 CATH. U. L. REV. 939 (1999).

93. *See* Kraakman et al., *supra* note 21, at 1738.

94. *See* United Airlines, Inc. v. McDonald, 432 U.S. 385, 401 (1977) (Powell, J., dissenting). "The Court . . . ignores the important 'principle that [s]ettlement agreements are highly favored in the law and will be upheld whenever possible because they are a means of amicably resolving doubts . . . and preventing lawsuits.'" *Id.* (quoting Pearson v. Ecological Science Corp., 522 F.2d 171, 176 (5th Cir. 1975) (citation omitted)).

95. *See* Coffee, *supra* note 22, at 16. The defendants in a derivative action can shift their litigation costs to the corporation when the suit is settled. *See id.* However, if the suit goes to trial and judgment, the losing party may not have its litigation costs reimbursed by the corporation. *See id.*

96. *See id.* at 17 (asserting that the financial burden falls more heavily on the defendant in a derivative action due to a greater commitment of resources to the discovery process, the need to engage multiple counsel and a difference in the fees and preparation usually involved by defendant's counsel).

97. The standard for review of a settlement and award of attorneys' fees is an abuse of discretion by the trial court. *See* Bell Atl. Corp. v. Bolger, 2 F3d 1304, 1305 (3d Cir. 1993). This is one of the more difficult standards to overcome, which decreases the likelihood that the settlement will be overturned. Affirmance of the settlement by an appellate court would add additional unwanted cost to the corporation, which is being pulled into the appellate process by another unsatisfied shareholder.

98. *See* Felzen v. Andreas, 134 F.3d 873, 875 (7th Cir. 1998), *aff'd per curiam sub nom. by an equally divided Court* Cal. Pub. Employees' Ret. Sys. v. Felzen, 525 U.S. 315 (1999) ("If in the course of managing or settling derivative litigation investors receive new injury, they do so only

corporation whole for its injuries rather than to redress the injuries sustained by the shareholders.[99] Therefore, a shareholder gains standing to sue through his status as representative of the corporation, not through his own injury.[100] Increasingly, however, courts have allowed derivative actions to go forward despite a lack of direct harm to the corporation, raising the concern that derivative actions are being used to avoid the limits placed on class actions by the Private Securities Litigation Reform Act.[101]

In addition, requiring intervention also avoids an improper challenge to the representative capacity of the plaintiff shareholder. Rule 23.1 requires that the plaintiff adequately represent the interests of the corporation.[102] Allowing a shareholder to challenge a settlement effectively permits the nonparty shareholder to challenge the representative capacity of the plaintiff shareholder without going through the normal steps required to both discredit the plaintiff shareholder and establish the representative capacity of the nonparty shareholder.[103] While the nonparty shareholder was allowed party status simply by objecting to a settlement, the original plaintiff shareholder is required to go through the pleading requirements such as the demand requirement and proof of adequacy of representation. Furthermore, the nonparty shareholder often only objects to the award of attorneys' fees, which are part of the settlement.[104] When the only objection is regarding the grant of attorneys' fees, the objector is allowed to accept the benefits of the settlement and attack the fees of the plaintiff's attorney who procured the benefits for the corporation.

The intervention requirement also seems more consistent with the direction

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because the corporation becomes worse off . . . .").

99. *See id.*

100. *See* Kaplan v. Rand, 192 F.3d 60, 66-67 (2d Cir. 1999); *see also Bell Atl. Corp.*, 2 F.3d at 1310 (noting that involvement as an objector at the settlement hearing was sufficient to provide standing).

101. *See* Michael A. Collora & David M. Osborne, *Class-Action Reforms Spur Derivative Claims: Shareholders Are Taking a Fresh Look at Derivative Suits to Pursue Investor Fraud Cases*, NAT'L L.J., Feb. 15, 1999, at B8 (citing Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified in scattered sections of 15 U.S.C.)).

102. *See* FED. R. CIV. P. 23.1 ("The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association.").

103. *See* 7C WRIGHT ET AL., *supra* note 41, § 1916 (stating that in a class action setting a prospective intervenor should make a motion to intervene as soon as it is apparent that the interests of the unnamed class members are not adequately represented).

104. *See* Rosenbaum v. MacAllister, 64 F.3d 1439, 1442-43 (10th Cir. 1995). The court determined that, although allowing a nonintervening class member to appeal a settlement would be disruptive to the litigation process, allowing appeal of just the attorney fee would not disrupt the benefits gained by the class and would only serve to increase the amount of benefit available to the class. *See id.* The court applied its analysis to the derivative action context and determined that "[t]he same considerations apply even more clearly . . . [when] the nonparty shareholder wishes to appeal only the fee allowed the party shareholder's attorney in a settlement." *Id.* at 1443.

provided by the Supreme Court in *Marino v. Ortiz*.[105] Appellate courts have often cited the decision in *Marino* when debating the forcefulness intended by the Court.[106]

> The rule that only parties to a lawsuit, or those that properly become parties, may appeal an adverse judgment, is well settled. The Court of Appeals suggested that there may be exceptions to this general rule, primarily "when the nonparty has an interest that is affected by the trial court's judgment." We think the better practice is for such a nonparty to seek intervention for purposes of appeal; denials of such motions are, of course, appealable.[107]

Although the Court's language does not provide a resounding rejection of the affected interest doctrine, it does state quite plainly that the "better practice" is intervention.[108] As the Court stated: "[W]e hold that because petitioners were not parties to the underlying lawsuit, and because they failed to intervene for purposes of appeal, they may not appeal from the consent decree approving that lawsuit's settlement . . . ."[109] Although *Marino* clearly implies that intervention should be required to have standing to appeal, the issue has not been foreclosed, as shown by its affirmation of *Felzen v. Andreas* by an equally divided court.[110]

Finally, intervention need not be as great a burden on the objecting shareholder as is often claimed by those advancing the nonintervention position.[111] First, the objecting shareholder need not intervene in order to make objections to the district court. The shareholder's right to present objections is provided by Rule 23.1. Therefore, the objecting shareholder desiring to avoid getting entangled in the litigation through intervention still has the ability to be heard albeit just not in the appellate courts. Shareholders who are willing to commit the time and resources needed to appeal should be willing to commit those same resources toward intervention to preserve the ability to appeal. An

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105. 484 U.S. 301 (1988) (per curiam).

106. *See* Kaplan v. Rand, 192 F.3d 60, 68 (2d Cir. 1999); Felzen v. Andreas, 134 F.3d 873, 874 (7th Cir. 1998), *aff'd per curiam sub nom. by an equally divided Court* Cal. Pub. Employees' Ret. Sys. v. Felzer, 525 U.S. 316 (1999); Bell Atl. Corp. v. Bolger, 2 F.3d 1304, 1307 (3d Cir. 1993).

107. *Marino*, 484 U.S. at 304 (citations omitted).

108. *Id.*

109. *Id.*

110. *See Cal. Pub. Employees' Ret. Sys.*, 525 U.S. at 315.

111. *See* Petitioner's Brief at 34, *Cal. Pub. Employees' Ret. Sys.* (No. 97-1732) (arguing that "requiring intervention would sharply curtail, if not eliminate, shareholder appeals and correspondingly impair the public functions they serve"); *see also* Brief of Amicus Curiae Council of Institutional Investors in Support of Petitioners at 16, *Cal. Pub. Employees' Ret. Sys.* (No. 97-1732) (arguing that requiring "shareholder objectors [to] intervene to secure the right to appeal a derivative settlement would erect an unnecessary and costly barrier to shareholder participation and undermine the fairness and integrity of derivative settlements without providing any offsetting benefit").

intervention requirement can facilitate the selection of objectors willing to commit resources to pursue their objections beyond the district court.

B. Disadvantages of the Intervention Position

Although there are several benefits to requiring intervention to gain status to appeal, many disadvantages are also present. Promoting efficiency, perhaps the main goal of the intervention requirement, has its costs. First, some commentators have suggested that a court may be inclined to accept a settlement in an effort to clear its docket of a complex piece of litigation.[112] Second, it is possible that engaging the corporation in extended litigation is likely to add additional legal costs to the action. However, the purpose of the appeal is to assert that the corporation should have received a better settlement from the defendants or should pay a lesser fee to the plaintiff's attorney. In either situation, the objecting shareholder is seeking appellate review in an attempt to either procure a better settlement for the corporation or to save the corporation from paying exorbitant attorneys' fees.

The argument that it is the corporation that has suffered harm, and not the shareholders, may be adhering to form over substance. "The proposition that an injury to the corporation is not an injury to its shareholders is dubious, 'since every injury to a corporation [necessarily has] an impact, however slight, on the shareholders as well.'"[113] When a corporation suffers injury that decreases its market value, the shareholders, as owners of the corporation, experience the loss.

However, the argument that shareholders are the injured parties was compellingly rejected in *Felzen*.[114] That court pointed out that shareholders "have no more right to speak for the firm or control its litigation decisions than bondholders or banks or landlords, all of whom have contractual interests that may be affected by litigation."[115] The court stated that simply having an affected interest is not adequate to develop standing to be considered a party to the lawsuit without formally becoming a party. Every shareholder of a corporation potentially has an affected interest, but the purpose of the derivative action is to allow a representative of the corporation to sue on behalf of the corporation, not to create a cause of action for all shareholders.[116]

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112. *See* Coffee, *supra* note 22, at 27 ("[T]he court may have incentives of its own not necessarily consistent with the public interest—namely, to clear a potentially messy and burdensome case from its docket."); *see also* Kim, *supra* note 92, at 120 ("With crowded dockets, courts may look unfavorably upon the specter of a complicated, time-consuming trial involving derivative claims.").

113. Kim, *supra* note 92, at 114 (quoting WILLIAM L. CARY & MELVIN ARON EISENBERG, CASES AND MATERIALS ON CORPORATIONS 1014 (7th ed. 1995)).

114. *See* Felzen v. Andreas, 134 F.3d 873, 874 (7th Cir. 1998), *aff'd per curiam sub nom. by an equally divided Court* Cal. Pub. Employees' Ret. Sys. v. Felzer, 525 U.S. 316 (1999).

115. *Id.*

116. *See* Papilsky v. Berndt, 466 F.2d 251, 255 (2d Cir. 1972). "The alleged injury inflicted upon the corporation is regarded as affecting only the corporation. The fact that the injury may

Essentially, allowing nonparty shareholders to appeal gives them the opportunity to challenge the representative status of the plaintiff shareholder. Yet, it often is not the representation of the corporation that is being challenged, but rather the fees that are paid to the attorney.[117] However, this viewpoint ignores the premise that an attorney is not a party to an action, but rather is the mouthpiece of the plaintiff shareholder. Although much of the distaste for derivative actions centers on the belief that the attorney is the real party driving the action in search of fees, this discounts the possibility that the plaintiff is involved and interested in the litigation.[118]

Critics of the *Felzen* opinion have generally argued that the court read too much into the holding of *Marino*.[119] *Felzen* can be distinguished from *Marino* simply on a factual basis—*Felzen* involved a derivative action, whereas *Marino* involved a class action.[120] However, nowhere in its opinion did the Court restrict its holding to class actions. Rather, the Court used broad language, simply stating that "only parties to a lawsuit, or those that properly become parties, may appeal an adverse judgment."[121]

Another concern with reliance on *Marino* is the brevity of the opinion and its reliance on authority that recognized exceptions that allow nonparties to appeal. "The result is clearly right; the brief statement that better practice demands intervention should not be taken to establish a requirement applicable to all circumstances."[122] One example of such a circumstance is *Kaplan*, in

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indirectly harm a stockholder by diminishing the value of his corporate shares does not bestow upon him a right to sue on his own behalf to recover damages." *Id.* The court then quoted Justice Frankfurter:

> The contrasting difference between a stockholder's suit for his corporation and a suit by him against it, is crucial. In the former, he has no claim of his own; he merely has a personal controversy with his corporation, . . . not a fraction of it to the stockholder. When such a suit is entertained, the stockholder is in effect allowed to conscript the corporation as a complainant on a claim that the corporation, in the exercise of what it asserts to be its uncoerced discretion, is unwilling to initiate.

Id. (quoting Smith v. Sperling, 354 U.S. 91, 99 (1957) (Frankfurter, J., dissenting)).

117. *See* Kaplan v. Rand, 192 F.3d 60 (2d Cir. 1999); *Felzen*, 134 F.3d at 873; Rosenbaum v. MacAllister, 64 F.3d 1439 (10th Cir. 1995).

118. The fact that the plaintiff's attorney is the actual force driving the lawsuit in search of fees is discussed in Part IV, *infra*. This is the foundation for relaxing standards to allow challenges to settlements, including the position that courts should make appellate review available to nonparty shareholders.

119. *See* Kim, *supra* note 92, at 112.

120. The distinction between a class action seeking monetary damages under Federal Rules of Civil Procedure 23(b)(3) and a derivative action is important to critics of the *Felzen* opinion because much reliance is placed on the argument that members of a class action have the ability to opt out of the litigation to avoid preclusion, whereas shareholders do not have an ability to opt out in a derivative action. *See* Kim, *supra* note 92, at 117-18; Fazendeiro, *supra* note 92, at 581.

121. Marino v. Ortiz, 484 U.S. 301, 304 (1988) (per curiam).

122. 15A WRIGHT ET AL., *supra* note 88, § 3902.1, at 130 n.52.

which the court determined that the requirement for intervention had not been established despite the nonparty having an interest affected by the litigation.[123] Admittedly, *Marino* took a rather soft position in finding that "the better practice" is intervention. Impliedly, the Court recognized that situations exist in which intervention is not required.[124]

IV. Allowing Non-Intervening, Objecting Shareholders Standing to Appeal Acceptance of a Settlement

A. Advantages of Allowing Appeal Without Intervention

Proponents of allowing objecting shareholders to appeal approval of the settlement without requiring intervention by shareholders rest their arguments primarily on the need to police collusive settlements. Several arguments have been advanced by the nonintervention camp. Minimizing the burden on objecting shareholders will encourage involvement in the settlement process, which is beneficial due to the inherent dangers of collusion and the need for the settlement process to be policed by independent shareholders. Inviting a shareholder to participate in the settlement hearing but refusing to hear him on appeal seems unfair. Shareholders have an affected interest in the settlement and, therefore, should be considered de facto parties for purposes of appeal. Shareholders do not have an ability to opt out of the settlement; thus, they are bound by the outcome. Finally, placing the plaintiff's attorney on notice that his fees can easily be challenged will encourage his pursuit of a real benefit for the corporation.

Furthermore, requiring intervention by objecting shareholders to secure appellate review may discourage some interested shareholders from becoming involved in the settlement process. Objectors play an important role in evaluating the settlement of derivative actions because as soon as the plaintiff and defendant have reached a possible settlement they will join forces to convince the trial court that the settlement is fair.[125] There seems to be a fear that the cost and time commitment of intervention will deter a shareholder with

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123. *See* discussion *supra* Part II.

124. *See Marino*, 484 U.S. at 304. "[T]he better practice is for such a nonparty to seek intervention for purposes of appeal . . . ." *Id.* Obviously, this is not the same as saying a nonparty must intervene. Thus, the door has been left open for debate about the forcefulness of the statement.

125. *See* Bell Atl. Corp. v. Bolger, 2 F.3d 1304, 1310 (3d Cir. 1993). The court stated:

> In assessing settlements of representative actions, judges no longer have the full benefit of the adversarial process. In seeking court approval of their settlement proposal, plaintiffs' attorneys' and defendants' interests coalesce and mutual interest may result in mutual indulgence. The parties can be expected to spotlight the proposal's strengths and slight its defects. In such circumstances, objectors play an important role by giving courts access to information on the settlement's merits.

Id. (citations omitted).

insufficient financial incentive to deal with the implications of becoming a party.[126] Institutional investors, as shareholders, probably have the greatest financial incentive to intervene, and with the most knowledgeable staff, they can offer valuable input into settlement analysis. However, institutional investors appear to have taken the position that requiring intervention may be too burdensome.[127]

An additional basis for the claim that objecting shareholders should have appellate standing is the affected interest rationale advanced in *Kaplan v. Rand*.[128] The shareholder has a direct interest in the litigation because a shareholder's interest is necessarily implicated by the actions of a corporation. Under the de facto party doctrine, a person may be entitled to appeal if, (1) he participated in the trial court proceedings as if he had intervened, and (2) equity weighs in favor of permitting appellate status.[129] Because of the concern for collusion in the derivative action setting, a good argument can be made that equity favors permitting appeal.

Another argument in support of appellate standing for objectors is that it makes little sense to invite shareholders to participate in the settlement process and then allow the trial court to reject the objections without recourse via appellate review. The procedural processes and recognition of nonparty shareholders under Rule 23.1 acknowledge the reality that a shareholder is affected by the judgment. This reality is evidenced by the fact that Rule 23.1 provides for proper notice to avoid severing the shareholder's rights through

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126. *See* O'Connell, *supra* note 92, at 969 (referencing the "procedural complexities, timing concerns, and litigation costs" associated with intervention); *see also* Petitioner's Brief at 34, 36, Cal. Pub. Employees' Ret. Sys. v. Felzen, 525 U.S. 315 (per curiam) (No. 97-1732).

> The legal hurdles to intervention by objecting shareholders . . . are daunting. . . .
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> . . . Shareholders wishing to preserve a right to appeal would face the added financial burden of drafting a pleading the equivalent of a complaint (expressly required by Rule 24) and litigating the timeliness of their motion and the adequacy of existing representation. They would also face all the costs and burdens associated with party status, including wide–ranging Rule 26(a)(1) automatic disclosure duties and the obligation to respond to interrogatories, appear for depositions, and answer virtually unlimited demands for documents.

Id.

127. *See* Brief of Amicus Curiae Council of Institutional Investors in Support of Petitioners at 3, 16, *Cal. Pub. Employees' Ret. Sys.* (No. 97-1732).

128. 192 F.3d 60 (2d Cir. 1999). *See also* discussion *supra* Part II.B.

129. *See* 15A WRIGHT ET AL., *supra* note 88, § 3892.1, at 122 ("Appeals have been permitted on showings that range from easy cases in which a nonparty is formally addressed by a court order through less clear cases in which a nonparty is significantly affected."); *see also* O'Connell, *supra* note 92, at 984-86 (suggesting that courts treat objecting shareholders as de facto parties for purposes of appeal). *But cf.* 15A WRIGHT ET AL., *supra* note 88, at 122 ("As the effect on the nonparty becomes more attenuated, however, a formal intervention procedure should be required as a means of ensuring control over appeals that carry a high potential for delay and abuse.").

representative litigation.[130] Further, the adversarial process justifies allowing the fairness of a settlement to be tested by appellate review.[131] Because the named plaintiff and the defendant have reached an agreement and cannot be expected to present any weaknesses in the settlement arrangement, objecting shareholders become the adversarial tool used to expose any such weaknesses.

Unlike members of some class actions, the shareholder does not have the ability to opt out of a derivative action.[132] The shareholder cannot separate himself from the litigation and pursue his own course of action. The shareholder's inability to opt out makes sense because the corporation can only litigate and recover for the cause of action once under the rules of claim preclusion. However, the effect in a derivative action is that the shareholders are basically bound by the results achieved by the representative plaintiff who first stepped forward.[133] Because the representative shareholder may not always be interested in the litigation, nonparty shareholders should be afforded more deference when challenging the settlement procured by the representative plaintiff.

Finally, appellate standing could, and probably would, be used to police what many believe to be the true weakness of a derivative action—the search for attorneys' fees. The benefit of allowing an appeal of only the attorneys' fees is that it would not implicate several of the concerns of efficiency in representative litigation.[134]

> To allow an individual dissident class member who did not intervene to appeal an attorney's fee award would not be nearly as disruptive. It would not affect the defendant who has paid into court or made other concessions necessary to settle the case. In the usual case, in which the settlement creates a fund to be shared by the plaintiff class, all of the assets the court would have ordered distributed to the class members could be distributed despite the appeal. The only result of allowing the appeal would be to delay the payment of fees and expenses to the attorneys for the plaintiff class. Should the dissident's appeal succeed

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130. *See* FED. R. CIV. P. 23.1 ("The action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to shareholders or members in such manner as the court directs.").

131. *See Kaplan*, 192 F.3d at 67.

132. *See* Bell Atl. Corp. v. Bolger, 2 F.3d 1304, 1308 n.4 (3d Cir. 1993). The court noted "that one of the rationales offered in support of an intervention requirement [in class action suits] cannot apply to derivative actions. That is, unlike members of a class certified under Rule 23(b)(3), 'shareholders normally cannot opt out of the class and pursue their own individual action.'" *Id.* (quoting AMERICAN LAW INSTITUTE, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 7.02, at 635 (Proposed Final Draft, Mar. 31, 1992)).

133. *See* Kraakman et al., *supra* note 21, at 1737 ("Under the American regime, they [shareholder plaintiffs] are more likely to be attorneys (with nominal shareholders in tow) in search of legal fees.").

134. *See* Rosenbaum v. MacAllister, 64 F.3d 1439, 1442 (10th Cir. 1995).

> in reducing those fees, there would be additional funds for later distribution to the class members.[135]

This rationale applies equally to the derivative suit, where any reduction of attorneys' fees would accrue to the corporation, thus increasing the settlement value to the corporation.

Attacking the plaintiff's attorneys' fees serves two purposes: (1) attorneys will be less willing to accept a reduced settlement amount in exchange for increased attorneys' fees, and (2) attorneys will be less inclined to bring actions that have a low likelihood of success. This also addresses the concern that even if a named shareholder is monitoring the derivative action, he is less likely to present opposition to fees requested by his attorney from the corporation than he is to object to a paltry settlement amount. Finally, because notice of a settlement usually only establishes a range on possible attorneys' fees, it is more difficult to object to the fees because they are not known until later in the process.[136]

B. Disadvantages of Allowing Appeal Without Intervention

Many of the arguments against the intervention requirement center upon the burden intervention places on the objecting shareholder. Often the objecting shareholder does not learn of the proposed settlement until quite late, with little time until the settlement hearing.[137] Timeliness can be a concern when intervention is sought. However, permissive intervention will likely be granted to the objecting shareholder should he desire intervention.[138] It is quite unlikely that the objecting shareholder who desires intervention would be denied intervention by the district court when objecting to a settlement.[139] However, even if intervention is denied, that denial would be appealable.[140] In addition, intervention can be granted for limited purposes, including appeal.[141] Therefore,

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135. *Id.*

136. *See id.* at 1442-43.

137. *See* Petitioner's Brief at 8, Cal. Pub. Employees' Ret. Sys. v. Felzen, 525 U.S. 315 (1999) (per curiam) (No. 97-1732). Petitioner had less than four weeks from receipt of the settlement notice to prepare objections. *See id.*

138. *See* 7C WRIGHT ET AL., *supra* note 41, § 1916, at 422. "The requirement of timeliness must have accommodating flexibility toward both the court and the litigants if it is to be successfully employed to regulate intervention in the interest of justice." *Id.*

139. Allowing intervention by the objecting shareholder seems to be a foregone conclusion. *See* United Airlines, Inc. v. McDonald, 432 U.S. 385, 386, 394-96 (1997) (permitting post-judgment intervention to a non-party member of a class action certification denial). "The critical inquiry in every such case is whether in view of all the circumstances the intervenor acted promptly after the entry of final judgment." *Id.* at 395-96.

140. *See* Marino v. Ortiz, 484 U.S. 301, 304 (1988) (per curiam).

141. *See* 15A WRIGHT ET AL., *supra* note 88, § 3902.1, at 113-14. "Intervention may be granted for specified purposes rather than for full participation in the litigation. If the limitation is not appealed, or is affirmed on appeal, the limited intervenor's standing on appeal is apt to be limited by the scope of the intervention." *Id.* at 113. Further, intervention can be sought solely for

courts may be willing to allow the shareholder to intervene for the sole purpose of ensuring appeal without requiring any additional involvement not otherwise contemplated by presentation of a meaningful objection.[142]

The argument that a shareholder should be considered a de facto party because his interest is being affected has several weaknesses. First, as the court pointed out in *Felzen*, it is the corporation that has suffered the harm and holds the cause of action.[143] Second, the Supreme Court has cast doubt on the viability of a doctrine conferring appellate status without intervention under the affected interest theory.[144] Additionally, under the de facto party doctrine, a person's involvement in a case usually must be substantial in order to be considered a de facto party.[145] Since objecting shareholders generally have not been involved in the case except for reviewing the proposed settlement, it does not appear that they meet the substantial involvement test. The objecting shareholders' involvement in the litigation is more akin to that of amicus curiae. Amicus curiae do not have standing to bring an appeal, but may gain standing through intervention in some instances.[146]

Is it logical to invite shareholders to present objections and not treat them as parties? One purpose for inviting shareholders to present objections is to ensure that the court receives a full presentation of the benefits and deficiencies associated with the proposed settlement, acknowledging that the adversarial process breaks down once the plaintiff and defendant have agreed to a proposed settlement.[147] Thus, the courts look to objecting shareholders to provide valuable information rather than to become parties to the underlying litigation. The former does not necessarily require the latter, as is clear when considering the

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the purposes of appeal. *See id.* at 114. "Intervention can support a nonparty appeal not only when intervention is sought to participate in the trial but also when intervention is sought *for the sole purpose of appeal.*" *Id.* (emphasis added).

142. For an example of involvement in settlement hearings as an objector, see Petitioners' Brief at 8, Cal. Pub. Employees' Ret. Sys. v. Felzen, 525 U.S. 315 (1999) (per curiam) (No. 97-1732). The petitioners had to "review the Settlement notice, hire counsel, obtain and review copies of pleadings in the case, weigh the fairness of the Settlement, draft a brief, and appear in court in Decatur, Illinois." *Id.*

143. *See* Felzen v. Andreas, 134 F.3d 873, 875 (7th Cir. 1998), *aff'd per curiam sub nom. by an equally divided Court* Cal. Pub. Employees' Ret. Sys. v. Felzen, 525 U.S. 315 (1999).

144. *See Marino*, 484 U.S. at 304.

145. *See* 15A WRIGHT ET AL., *supra* note 88, § 3902.1, at 106.

> Appeals by those who participated as if parties are frequently entertained despite a failure to achieve formal status as a party. Most of these appeals involve persons who participate in trial court proceedings as if they had intervened, and who seem to have been treated on all sides as de facto parties.

Id.

146. *See id.* at 106 n.12.

147. *See* FERRARA ET AL., *supra* note 3, § 14.05 ("Courts also consider both the relative number of objectors and the nature of their objections in considering whether a proposed settlement is entitled to a presumption of fairness.").

status of amicus curiae.

One reason advanced for treating shareholders differently than class members is their inability to opt out of the litigation.[148] However, the reason shareholders cannot opt out of derivative litigation is because they do not have an injury recognized by the courts.[149] Only one entity can recover in a derivative action: the corporation. In a class action, multiple injuries are consolidated into one action.[150] An analysis based upon a lack of an opt out provision concentrates on the wrong entity's injury when considering a derivative action.[151] The reason a shareholder cannot opt out of a derivative action is because the suit could not be controlled if multiple shareholders were pursuing parallel actions. The same concern arises in the appellate courts. One representative of the corporation is entitled to pursue the claim for the corporation, and if his representation is deemed inadequate, the proper method is to challenge the representative's status and replace him in the litigation, not to make collateral attacks once the suit has been concluded.

Finally, allowing shareholders to attack just the attorneys' fees after settlement of the action could have a chilling effect on bringing suit in the first place. Of course, the purpose of this viewpoint is to discourage frivolous suits, not meritorious ones. Derivative actions do provide a useful means to protect shareholders, and going too far in the interest of preventing attorney fee abuses could prevent useful actions from being litigated. However, possible settlement attacks are not likely to deter attorneys from bringing meritorious suits. The ability to attack an attorney's fees can result in a strike suit of its own. Assuming the basis for a strike suit is that avoidance of litigation costs has a settlement value of its own, suits could be filed to reduce an attorney's fees simply to force the attorney to reduce some of her fees to avoid protracted litigation. Although the recovery of fees would accrue to the corporation, under the derivative action rules, the objecting attorney would be entitled to a portion of the savings intended for the corporation.[152] If one assumes that some attorneys are in the business of bringing harassing lawsuits for their settlement value, that assumption can be applied to the foregoing situation. However, it is unlikely that unmeritorious attacks on an attorney's fees will meet little resistance from the attorney like it does from the corporation. Unlike a defendant in a derivative action, the attorney pays his own litigation costs.[153]

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148. *See* Bell Atl. Corp. v. Bolger, 2 F.3d 1304, 1308 n.4 (3d Cir. 1993).

149. *See* Felzen v. Andreas, 134 F.3d 873, 875 (7th Cir. 1998), *aff'd per curiam sub nom. by an equally divided Court* Cal. Pub. Employees' Ret. Sys. v. Felzen, 525 U.S. 315 (1999).

150. *See* FED. R. CIV. P. 23. Under Rule 23(c) class members may elect to opt out of the class action upon receipt of notice of the action. If the class member fails to opt out, his interest will be litigated by the class representative.

151. *See Felzen*, 134 F.3d at 875.

152. Attorneys are entitled to payment of their fees by the corporation when they provide benefits to the corporation. Those benefits can be monetary or therapeutic in nature. *See* FERRARA ET AL., *supra* note 3, § 14.05.

153. Normal hindrances against bringing such a suit would exist, such as Rule 11 sanctions.

V. Recommendations

Two main concerns must be addressed when determining whether intervention should be required to appeal a settlement of a derivative action. One concern is how to avoid the agency costs inherent in a system in which an attorney usually directs the litigation efforts of a named shareholder who may not be monitoring the litigation. The countervailing concern is how to minimize the complexity and costs of extending a lawsuit that costs a corporation both human and monetary resources.

In confronting the agency problems, an overriding mistrust of plaintiffs' attorneys has developed because of the numerous examples of derivative settlements that seemingly benefit only the attorney.[154] Some believe that requiring intervention will help address the agency problem by encouraging more shareholders to get involved in presenting objections, knowing that their denial will be automatically appealable.[155] However, this view places too much reliance on the contention that intervention places an added burden on shareholders, which they are unwilling to bear. First, the requirement of intervention to gain appellate standing does not place any additional burden on shareholders who have no intention to pursue appeal but who, instead, wish to make their objections known to the trial court. Second, intervention may be granted for limited purposes. For those shareholders willing to commit substantial resources to present objections to the district court, intervening for the limited purpose of appealing an award of attorneys' fees may do little to add to the cost but do more to convince the settling parties of the shareholder's seriousness. Therefore, requiring intervention may actually convince the court and litigating parties that an objecting shareholder is serious enough to continue his efforts on appeal, and, at the same time, do little to affect those shareholders only willing to make an appearance to present objections.

Requiring intervention would serve the purpose of allowing the corporation to control and anticipate its litigation costs. Without requiring intervention, the courts face the problem that every objecting shareholder has standing to bring an appeal. This problem can undermine the purpose behind representative litigation,

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Attorneys would probably be more aggressive at fending off unmeritorious litigation than corporations have been, since their own money is at stake as opposed to directors of a corporation who may be willing to settle because they are indemnified by the corporation. *See* Coffee, *supra* note 22, at 13-14 (suggesting that defendants to derivative actions have failed to take aggressive positions to discourage future lawsuits that may lack merit because it is often cheaper to settle the current suit even though in the long run it encourages future suits brought for their settlement value).

154. *See id.* at 28-31 (giving examples of two cases that appear to have provided no tangible benefit to anyone except the plaintiff's attorneys).

155. *See* Kim, *supra* note 92, at 134, Fazendeiro, *supra* note 92, at 589-90; O'Connell, *supra* note 92, at 987-88 (all determining that intervention was unnecessary and would result in less shareholder involvement in presenting objections and keeping plaintiff attorneys in check).

which is to simplify an action in which numerous possible parties desire to bring the same claim by placing that action in the hands of a qualified representative. Without this consolidation of claims, the litigation becomes unmanageable and extremely costly to both the corporation and the already overburdened court system.

Conclusion

Derivative actions have likely fallen out of favor with most groups except the plaintiff attorneys who initiate them. Allowing any shareholder with an affected interest to appeal just because the corporation may be entering into a bad bargain could serve to complicate and further protract litigation that the corporation desires to end. An intervention requirement allows both the courts and the corporation to better control the litigation process, and does not place so great a burden on objecting shareholders that they will not be able to present their objections. The Supreme Court should follow the Seventh Circuit's lead and require intervention before an objecting shareholder is allowed to appeal a settlement.

CASTING THE DISCOVERY NET TOO WIDE: DEFENSE ATTEMPTS TO DISCLOSE NONPARTY MEDICAL RECORDS IN A CIVIL ACTION

DANEL MICHELLE NICKELS*

INTRODUCTION

Imagine that you are a parent who has just filed a negligence suit on behalf of your child. Although not a party to the suit, the defense seeks the release of your personal medical, psychiatric, and school records to challenge your child's claims of causation. It is not unreasonable that your initial reaction would be surprise or even shock given that such practices threaten to invade your most intimate and personal information. Yet, these types of practices by civil defense teams are becoming widespread as a means to support alternative theories of causation.[1] For example, in *Bogues v. 354 E. 21st Street Realty Corp.*,[2] Ms. Thomasina Jones, mother of six-year-old Randy Bogues, Jr., found her own health to be the subject of inquiry after she filed suit on behalf of her son for injuries he allegedly suffered from lead poisoning.

Privacy considerations strike a deep chord within citizens given that privacy is deemed one of the most sacred and fundamental rights.[3] Although the word "privacy" cannot be found in the U.S. Constitution, most people firmly believe that they have an inherent, fundamental right to be left alone.[4] Yet, in areas ranging from abortion to the information highway, courts have defined the scope of privacy in non-absolute terms, especially when competing values are at stake.[5] In the context of discovery of nonparty medical records, the preservation of confidentiality has surfaced as a source of national concern.[6] Courts face an

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1. *See* Hope Viner Samborn, *Blame It on the Bloodline: Discovery of Nonparties' Medical and Psychiatric Records Is Latest Defense Tactic in Disputing Causation*, A.B.A. J., Sept. 1999, at 28-29 (discussing the controversy surrounding discovery of nonparties' medical information).

2. *See id.* at 28 (citing *Bogues*, No. 11394-96 (N.Y. Sup. Ct. Aug. 22, 1996)).

3. *See* Arthur R. Miller, *Confidentiality, Protective Orders, and Public Access to the Courts*, 105 HARV. L. REV. 427, 475 (1991) ("Privacy [is] . . . among the most fundamental rights that we have as citizens of this country.").

4. *See* ELLEN ALDERMAN & CAROLINE KENNEDY, THE RIGHT TO PRIVACY, at xiii (Vintage Books 1997) (1995).

5. *See id.* at xiv.

6. *See id.* at 336-37.

> The erosion of medical confidentiality has also become a source of national concern. . . .
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> . . . The private sector can already link our financial, medical, telephone, cable, and computer information to create profiles of our habits, behavior, and interests, as well as

intense struggle between protecting the due process considerations of defendants who argue that the fair administration of justice demands disclosure of nonparties' medical records to pursue alternative causation theories and safeguarding the privacy interests of persons not party to a suit who seek to keep their medical information confidential.

Drawing on *Bogues* and other recent jurisprudence addressing the issue of discovery of nonparties' medical information,[7] Part I of this Note will briefly survey the competing interests of the defense's concern with due process, the ability to fully and fairly represent their client, and the nonparty's interest in preserving the privacy of his or her confidential medical information. In Part II, this Note explores the potential negative ramifications of defense attempts to disclose private medical information in civil proceedings. Part III of this Note examines measures designed to safeguard the privacy interests of nonparties, including in camera inspection of medical records, redaction of names and identifying numbers from the medical records, and granting of protective orders.

Part IV of this Note discusses the merits of treating medical information as a property right so as to limit disclosure of highly sensitive personal information. Part V of this Note explores the potential merits of recognizing a constitutionally-protected right to privacy as another way to insulate a nonparty from defense attempts to obtain private medical records. After weighing the relative strengths and weaknesses of the various approaches to safeguarding a nonparty's privacy interest in medical information confidentiality, Part VI recommends that a constitutional right to informational privacy, coupled with protective orders and in camera review, may be the most effective way to protect a nonparty's privacy interest while accommodating the defense's need to disclose as much information

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> diseases we have and those we are likely to get.
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> . . . [W]hen information is collected, particularly sensitive personal information, it is often abused.

Id.; *see also* Madison Powers, *Justice and Genetics: Privacy Protection and the Moral Basis of Public Policy*, *in* GENETIC SECRETS: PROTECTING PRIVACY AND CONFIDENTIALITY IN THE GENETIC ERA 355 (Mark A. Rothstein ed., 1997) ("[T]his revitalized interest in privacy protection is the awareness that although an increase in health information available to medical researchers and caregivers can be used for great good, it can also have adverse economic and social consequences for individuals and groups.").

7. *See, e.g.*, Rodriguez v. Suzuki Motor Corp., 936 S.W.2d 104 (Mo. 1996) (denying release of nonparty's medical records where the relevancy threshold could not be met by the defense because of strong tendency to confuse the jurors and where privilege concerns could not be outweighed by other factors); Monica W. v. Milevoi, 685 N.Y.S.2d 231, 234 (App. Div. 1999) (rejecting defense request for disclosure of nonparty siblings' school records and for the parents' drug and pregnancy histories explaining that the defense suggestion that the plaintiff's problems were genetically- or environmentally-related was "speculative, at best"); Anderson v. Seigel, 680 N.Y.S.2d 587 (App. Div. 1998) (allowing disclosure of the academic records of the plaintiff's siblings and mother, the mother's employment records, and the mother's IQ tests, reasoning that these documents were relevant to the issue although some of the highly sensitive information should be reviewed in camera prior to release to protect privacy interests of nonparties).

as possible to fully and fairly represent its clients.

I. Competing Interests at Stake in Discovery of Nonparty Records

A. Defense Due Process Concerns

The U.S. Constitution provides that "[n]o state shall . . . deprive any person of life, liberty, or property, without due process of law."[8] In the context of discovery in civil proceedings, due process includes a defendant's right to investigate and construct alternative theories of causation in order to prevent civil liability from attaching to him or her. In the U.S. adversary system, the overarching goal of the courts in all civil suits is "to secure the just, speedy, and inexpensive determination of every action."[9] With this in mind, courts generally operate under a liberal policy of disclosure.[10] This policy tends to favor defense attempts to disclose medical and other records of nonparties, provided that the defense establishes the relevancy and materiality of such documents to the issue in dispute.[11]

Defense attorney Michael Bernstein of New York City explains that in order to fully and fairly represent a client in medical malpractice, medical products liability, and toxic tort cases, due process requires that nonparty medical and other records be disclosed so that defendants may pursue alternative causation theories of plaintiff's alleged cognitive defects and other behavioral and developmental deficiencies.[12] For example, in toxic tort and medical malpractice cases involving children, a common question is whether the act or product of the defendant injured the child's mental and intellectual development.[13] Child

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8. U.S. CONST. amend. XIV, § 1.

9. FED. R. CIV. P. 1. Most states pattern their rules of civil procedure on the FRCP. *See, e.g.*, Lee v. Elbaum, 887 P.2d 656 (Haw. Ct. App. 1993); Turgut v. Levine, 556 A.2d 720 (Md. Ct. Spec. App. 1989); Wilson v. Piper Aircraft Corp., 613 P.2d 104 (Or. Ct. App. 1980).

10. *See* Miller, *supra* note 3, at 466 ("The broad discovery procedures in the Federal Rules were designed solely to improve the dispute resolution system. The drafters had no intention of using these procedures to undermine privacy; nor were they expanding discovery in the name of promoting public access to information."); *see also* Terre Haute Reg'l Hosp., Inc. v. Trueblood, 600 N.E.2d 1358, 1361 (Ind. 1992) (Just "[a]s a doctor and patient need full disclosure in order for the doctor to 'best' diagnose his patient, the court seeks full disclosure to 'best' ascertain the truth."); Cynthia B. v. New Rochelle Hosp. Med. Ctr., 458 N.E.2d 363, 369 (N.Y. 1983).

11. *See Monica W.*, 685 N.Y.S.2d at 233 ("[T]he relevancy of the information sought must be established before discovery will be permitted to go forward . . . [and] non-medical records of academic and cognitive performance, though not within any privilege, 'are not discoverable unless the party seeking their production establishes their relevance and materiality for discovery purposes.'") (quoting McGuane v. M.C.A., Inc., 583 N.Y.S.2d 73, 74 (App. Div. 1999)); *see also* FED. R. CIV. P. 26(b)(1) ("The information sought need not be admissible at the trial if the information sought appears reasonably calculated to lead to the discovery of admissible evidence.").

12. *See* Samborn, *supra* note 1, at 29.

13. *See* Ronald L. Hack & Jane E. Schilmoeller, *Production of Non-Parties' Medical and*

psychologists and pediatric neurologists recognize that in order to determine whether a causal relationship exists, factors such as parental intelligence and social environment must be considered based on review of medical and school records, interviews, and testing of parents, siblings, and close family members.[14]

Moreover, defendants argue that a plaintiff's privileged information or any right to privacy he or she may have with respect to medical records is not absolute, especially in light of a defendant's due process concerns and the judicial system's pursuit of truth.[15] Due to the strong presumption in favor of the truth-finding process, courts have recognized that, even when privileged information is at stake, the information sought may be discoverable upon the defense showing that the material is relevant to the issue in dispute.[16]

Generally, discovery is governed by Federal Rule of Civil Procedure 26, which provides in relevant part that "[p]arties may obtain discovery regarding any matter, not privileged, which is relevant to the subject matter involved in the pending action."[17] Moreover, pursuant to a provision added in the 1970 amendments to the Federal Rules of Civil Procedure, Rule 34(c) contemplates discovery of "documents and things" from persons who are not parties to an action.[18]

Relevancy must be demonstrated by more than just a conclusory statement in an attorney's brief.[19] Defense attorneys must show some fit or nexus between

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Other Privileged or Private Records, 54 J. MO. B. 123, 126 (1998).

14. *See id.*

15. *See* Anne Bowen Poulin, *The Psychotherapist-Patient Privilege After* Jaffee v. Redmond*: Where Do We Go from Here?*, 76 WASH. U. L.Q. 1341, 1341-42 (1998); *see also* Todd v. S. Jersey Hosp. Sys., 152 F.R.D. 676, 684 (D.N.J. 1993) (quoting Wei v. Bodner, 127 F.R.D. 91, 97 (D.N.J. 1989) (explaining that the physician-patient privilege is not absolute and "must be subrogated to more important interests of society [like the search for truth]")).

16. *See* Terre Haute Reg'l Hosp., Inc. v. Trueblood, 600 N.E.2d 1358, 1362 (Ind. 1992); *see also* Palay v. Superior Court of L.A., 22 Cal. Rptr. 2d 839, 843-46 (Ct. App. 1993) (holding that the nonparty mother was prohibited from invoking a privilege against disclosure of her prenatal records because they are "inextricably intertwined" with the health of her infant son). The *Palay* court further explained that "[t]he patient-litigant exception precludes one who has placed in issue his physical condition from invoking the privilege on the ground that disclosure of his condition would cause him humiliation. He cannot have his cake and eat it too." *Id.* at 844 (quoting City & County of S.F. v. Superior Court, 231 P.2d 26, 28 (Cal. 1951)).

17. FED. R. CIV. P. 26(b)(1).

18. FED. R. CIV. P. 34(c) ("A person not a party to the action may be compelled to produce documents and things or to submit to an inspection as provided in Rule 45."); *see also* FED. R. CIV. P. 45(b) (allowing such discovery against a nonparty through the issuance of a subpoena duces tecum). A subpoena duces tecum is "[a] subpoena ordering the witness to appear and to bring specified documents or records." BLACK'S LAW DICTIONARY 1440 (7th ed. 1999).

19. *See* Herbst v. Bruhn, 483 N.Y.S.2d 363, 366 (App. Div. 1984) ("[A]n attorney's affidavit in support of disclosure containing bare unsubstantiated conclusory statements as to relevance is insufficient to establish a factual predicate for the disclosure of the medical records of a nonparty whose personal physical condition is not in issue.").

the information sought from the nonparty's medical records and the issue in dispute. For example, in *Monica W. v. Milevoi*,[20] several landlords were sued by children who formerly resided in their buildings. The suit alleged lead paint poisoning caused by certain developmental impairments. The landlords moved to disclose the nonparty siblings' confidential medical and non-medical information to show possible alternative causes for the developmental impairments, such as heredity and environment.[21] The court held that the defendants' discovery demand swept too broadly and that they failed to establish the relevancy of the requested information, explaining that:

> Defendants have presented no affidavit by any expert to demonstrate that the extent to which the adverse affects [sic] of lead exposure contributed to the mental and physical condition of the infant plaintiffs cannot be ascertained by reference to objective clinical criteria and expert testimony. Nor have defendants shown how the information sought to be elicited at an examination before trial of the adult plaintiff pertains to any disability or developmental impairment experienced by the infant plaintiffs.
>
> . . . Defendants' intimation that genetic and other environmental factors may have contributed to the infant plaintiffs' impairment is speculative, at best . . . .[22]

The standard procedure for a showing of relevancy requires the moving party seeking disclosure of the nonparty records to demonstrate "both substantial need and the unavailability of a substantial equivalent."[23] In addition to relevancy, defendants are also charged with demonstrating that the information sought is "material and necessary to their defense of the action, and that the information could not be obtained from another source."[24] Because it is unclear what is needed to establish a sufficient showing of relevancy, courts have resolved to make such determinations on an ad hoc basis.[25]

B. Nonparty's Privacy Interests

Although the judicial system's overarching goal is to discover the truth, which requires assembling all the testimony and documents that bear on the facts of the case from parties and nonparties alike, nonparties maintain a strong interest in preserving the privacy of their medical and other confidential information. This interest in protecting the privacy of one's medical information

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20. 685 N.Y.S.2d 231 (App. Div. 1999).

21. *See id.* at 233.

22. *Id.* at 234.

23. Hack & Schilmoeller, *supra* note 13, at 126.

24. Gilroy v. McCarthy, 678 N.Y.S.2d 644, 645 (App. Div. 1998) (citations omitted).

25. *See* Hack & Schilmoeller, *supra* note 13, at 126. *See, e.g.*, Amente v. Newman, 653 So. 2d 1030 (Fla. 1995); Terre Haute Reg'l Hosp., Inc. v. Trueblood, 600 N.E.2d 1358 (Ind. 1992); State *ex rel.* Wilfong v. Schaeperkoetter, 933 S.W.2d 407 (Mo. 1996) (en banc).

is embodied in privilege law, which takes shape mostly in state statutes,[26] because there is no federal law governing the physician-patient privilege.[27] In creating a physician-patient privilege, state legislatures have struck a balance between society's interest in preserving the confidential relationship of a patient and physician and society's interest in ascertaining the truth in civil litigation.[28]

The physician-patient privilege is a central, underlying concern in cases that deal with defense attempts to disclose nonparty medical records. Physicians are sworn to respect the private information that patients reveal to them in confidence.[29] Privilege law respects the realm of privacy that surrounds the physician's relationship with his or her patient.

The physician-patient privilege serves several compelling interests. First, the privilege encourages patients to fully disclose their personal information to physicians in order to obtain appropriate treatment.[30] Second, the privilege "prevents public disclosure of socially stigmatizing diseases."[31] Third, the privilege, in some circumstances, insulates patients from self-incrimination.[32] Finally, the privilege allows the public to rely upon the expectation that

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26. *See* Poulin, *supra* note 15, at 1341-42; *see also In re* Fink, 876 F.2d 84, 85 (11th Cir. 1989) (explaining that in diversity actions, state law governs privileged materials requested in discovery and Florida courts applying Florida privilege law have consistently denied discovery of nonparty medical records); Brown v. St. Joseph County, No. S90-221, 1992 WL 80806, at *4 (N.D. Ind. Apr. 3, 1992) (referring to Indiana physician-patient privilege law); Dierickx v. Cottage Hosp. Corp., 393 N.W.2d 564, 566 (Mich. Ct. App. 1986) ("The purpose of [Michigan's] physician-patient privilege is to enable persons to secure medical aid without betrayal of confidence."); David L. Woodard, Comment, *Shielding the Plaintiff and Physician: The Prohibition of Ex Parte Contacts with a Plaintiff's Treating Physician*, 13 CAMPBELL L. REV. 233, 236-37 (1991) (explaining that North Carolina's physician-patient privilege law extends not only to testimonial information but observational knowledge by the physician during the course of examination).

27. *See* Woodard, *supra* note 26, at 237; *see also* ALDERMAN & KENNEDY, *supra* note 4, at 336 ("Many people are surprised to find that there is a federal law protecting the confidentiality of the videos they rent, but that there is no federal law protecting the confidentiality of our medical records."); Chari J. Young, Note, *Telemedicine: Patient Privacy Rights of Electronic Medical Records*, 66 UMKC L. REV. 921, 933 (1998) ("Can state residents turn to federal privacy protections of their medical records? No, there is not much protection of medical records at the federal level—legal protections for health information are generally found at the state level.").

28. *See* Joseph S. Goode, Note, *Perspectives on Patient Confidentiality in the Age of AIDS*, 44 SYRACUSE L. REV. 967, 982-83 (1993) ("The physician-patient privilege derives from the general duty of confidentiality and assures that the sacrosanct concept of confidentiality is protected when a patient's medical information is required in legal proceedings.").

29. *See* TABER'S CYCLOPEDIC MEDICAL DICTIONARY 769 (15th ed. 1985) (Oath of Hippocrates) ("[W]hatever, in connection with my professional practice, or not in connection with it, I see or hear, in the life of men, which ought not to be spoken abroad, I will not divulge as reckoning that all such should be kept secret . . . .").

30. *See* Woodard, *supra* note 26, at 237.

31. *Id.* at 237-38.

32. *See id.* at 238.

physicians will not reveal their personal confidences.[33]

Importantly, "[a] plaintiff does not waive his or her physician-patient privilege with respect to his or her own medical history merely by acting in a representative capacity for the purpose of litigation in which the plaintiff's infant . . . is the real party in interest."[34] For example, in *Herbst v. Bruhn*,[35] a mother filed a medical malpractice action on behalf of her infant son against several physicians and a hospital. The defendants sought disclosure of the mother's medical and family history records to show that the alleged mental impairment of her infant son was inherited.[36] The court held that the mother did not waive her physician-patient privilege regarding her own medical history by simply acting as a representative for her infant son.[37]

However, courts have generally recognized an exception to this rule when defendants seek the medical records of the nonparty mother for the time period when the fetus was in utero.[38] For example, in *Palay v. Superior Court of Los Angeles*,[39] a mother, a nonparty in the action, filed a medical malpractice action on behalf of her sixteen-month-old child. She sought a writ of mandate to compel the Superior Court of Los Angeles to vacate an order requiring production of her prenatal medical records.[40] The court held that the prenatal medical records of the nonparty were discoverable and not subject to the physician-patient privilege because the medical histories of the mother and child while the child was in utero were inextricably related.[41] Because discovery of medical records of a nonparty mother constituted a matter of first impression in California, the court in *Palay* looked to other states, specifically New York, for guidance. Importantly, allowing discovery of nonparty mothers' prenatal records based on the theory of "impossibility of severance" does not allow defendants unlimited access to disclosure of a mother's entire medical history.[42]

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33. *See id.* at 248.

34. Martin B. Adams, *Medical Malpractice Case Management in Discovery: A Defense Perspective*, 421 PRACTICING L. INST. 43, 89 (1991); *see also* Herbst v. Bruhn, 483 N.Y.S.2d 363 (App. Div. 1984).

35. 483 N.Y.S.2d 363 (App. Div. 1984).

36. *See id.* at 364.

37. *See id.* at 365.

38. *See id.*

39. 22 Cal. Rptr. 2d 839 (Ct. App. 1993).

40. *See id.*

41. *See id.* at 846. The court stated:

> The history of events during pregnancy set forth in Mother's prenatal records are a source of relevant information about the crucial period of the infant's gestation, and therefore a proper subject for inquiry. Defendants have no other means by which to obtain this information. Therefore, . . . when we weigh Mother's privacy rights against defendants' legitimate interest in preparing their defense, we find that defendants' interest must prevail.

Id. at 848.

42. *In re* N.Y. County DES Litig., 570 N.Y.S.2d 804, 805 (App. Div. 1991) ("[A] mother's

II. Potential Negative Ramifications of Disclosure

A. Discrimination

The cost of accommodating the defense's need for nonparty medical records in order to support alternative causation theories can be overwhelming to a nonparty in many respects.[43] There are three critical interests of the nonparty that may be sacrificed on the altar of discovery. They are a nonparty's 1) social and economic well-being, 2) psychological stability, and 3) autonomy.[44]

First, an important interest for a nonparty is the protection of his social and economic well-being.[45] A person's livelihood can depend on how much of his or her sensitive and personal information is accessible to others.[46] For instance, disclosure of private medical information may cause a profound wave of adverse social and economic consequences, including the loss of employment opportunities and insurability.[47]

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medical records pertaining to the period when the infant was in utero are discoverable on the ground that there can be no severance of the infant's prenatal history from the mother's medical history."); *see also* Scharlack v. Richmond Mem'l Hosp., 477 N.Y.S.2d 184, 187 (App. Div. 1984) (explaining that as the nominal representative of the infant plaintiff in a medical malpractice action, the nonparty mother "can be deemed to have waived the physician-patient privilege only with respect to the medical history and records pertaining to the period when the infant plaintiff was in utero, during which time there could be no severance of the infant's prenatal history from his mother's medical history"); Burgos v. Flower & Fifth Ave. Hosp., 437 N.Y.S.2d 218, 219 (Spec. Term 1980).

> During [pregnancy] there could be no severance of a mother from child. Neither can we sever the infant's prenatal history from the mother's medical history during that period. As the infant's privilege has been waived we cannot allow the mother's privilege to be interposed to the defendants' right to all of the infant's medical history.

Id.

43. *See* Roger E. Harris, Note, *The Need to Know Versus the Right to Know: Privacy of Patient Medical Data in an Information-Based Society*, 30 SUFFOLK U. L. REV. 1183, 1185 (1997) ("[M]odern medical records not only contain diagnoses and treatment related data, but also contain personal information such as employment history, financial history, lifestyle choices, and HIV status.").

44. *See* Powers, *supra* note 6, at 357-59 (noting heightened concern for privacy when genetic information is involved).

45. *See id.* at 357.

46. *See id.*

47. *See id.*; *see also* Samborn, *supra* note 1, at 29 (suggesting that defendants, many of whom are insurance companies, might use the nonparties' medical and other records against them at a later date to deny coverage for a pre-existing condition); Natalie Anne Stepanuk, Comment, *Genetic Information and Third Party Access to Information: New Jersey's Pioneering Legislation as a Model for Federal Privacy Protection of Genetic Information*, 47 CATH. U. L. REV. 1105, 1117-20 (1998) (discussing the potential harm that may result from the disclosure of an individual's genetic

A second valuable interest for the nonparty is psychological stability. The dissemination of highly personal information to others may cause severe emotional distress if the nonparty senses a loss of dignity and respect from others.[48] Controlling the release of intimate information about oneself is central to an individual's self-concept and function in society, especially given the risk that others will wrongly perceive that individual as "lacking in intellectual abilities . . . [being] emotionally unstable, [and] pos[ing] an added risk to the physical safety of others."[49]

A third interest that a nonparty may have in limiting others' access to private information is autonomy, an individual's ability to make and act on his or her own choices.[50] For instance, with the amount of genetic information that may be found in medical records, an individual may be deterred from pursuing a change in employment for fear of an inability to obtain insurance coverage in the future.[51] Thus, disclosure of highly sensitive and personal information can severely impinge a person's life choices.

B. Intimidation

Jennifer Wriggins, a law professor at the University of Maine, states that defendants often use disclosure of nonparties' medical and other personal records to intimidate nonparties who fear the release of embarrassing medical information.[52] For instance, compelling privacy interests are at stake when dealing with the highly sensitive information that is obtainable from genetic tests. These tests can reveal current medical conditions or the risk of developing future diseases. Access to an individual's genetic information may prompt others to overreact or unjustifiably alter their interaction with the individual, whether or not the genetic information accurately predicts disease or physical or mental dysfunction.[53] In many instances, this type of reaction by others spells social stigma for the individual or even discrimination in the areas of employment and insurance.[54]

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information); Young, *supra* note 27, at 928-29 (explaining that once a case is litigated and then becomes public record, the inclusion of a nonparty's sensitive information may result in discrimination in the employment context, possibly ruining a private citizen's career or negatively affecting her ability to even secure employment).

48. *See* Powers, *supra* note 6, at 358.

49. *Id.*

50. *See id.* at 359; *see also* Young, *supra* note 27, at 929 ("Health care information can influence decisions about an individual's access to credit, admission to academic institutions, and his or her ability to secure employment and insurance. . . . [I]mproper disclosure [of this information] can deny an individual access to these basic necessities of life, and can threaten . . . personal and financial well-being.").

51. *See* Powers, *supra* note 6, at 359.

52. *See* Samborn, *supra* note 1, at 29.

53. *See* Powers, *supra* note 6, at 357-58.

54. *See id.* at 357-58.

Intimidation can cause profound psychological harm to an individual who fears the disclosure of highly sensitive information and may even destabilize his or her very self-concept and capacity for functioning in society.[55] Therefore, control over one's personal information is fundamentally important to individuals. Control over such information gives people confidence and assurance that they can avoid the shame and embarrassment of public disclosure of highly intimate and personal information.[56] Control over this information also gives people the freedom "to pursue their education, careers, friendships, romances, and medical care without the oversight, interference, or other unwelcome involvement of others."[57] Thus, confidentiality of medical information, especially genetic information, is of special importance when the disclosure of highly intimate information, such as one's predisposition to a certain disease or even one's sexual preference, can lead to unwelcome responses by others.[58]

C. *"Chilling Effect" on Patient Communications*

In addition to the social, economic, and psychological harms that may follow disclosure of a nonparty's private information, such disclosure can also cause a "chilling effect" upon the communication between patients and their physicians.[59] For example, the physician-patient privilege under Indiana law, "has been justified on the basis that its recognition encourages free communications and frank disclosure between patient and physician which, in turn, provide assistance in proper diagnosis and appropriate treatment."[60] Given the personal nature of

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55. *See id.*

> [A]lthough there is no inherent reason why someone should feel ashamed or embarrassed by the fact that he or she has a genetic risk of developing an inheritable psychiatric condition, others falsely may conclude that the individual is lacking in intellectual abilities, is emotionally unstable, or poses an added risk to the physical safety of others.

Id. at 358.

56. *See* David Orentlicher, *Genetic Privacy in the Patient-Physician Relationship*, *in* GENETIC SECRETS, *supra* note 6, at 77, 79.

57. *Id.*

58. *See id.* at 79-80. "Disclosure of medical information may also lead to stigmatization and discrimination. People with HIV infection may be shunned by family, friends, and others, evicted from housing, fired from employment, and denied insurance. Even when reactions are less extreme, people frequently are treated differently . . . ." *Id.* at 79.

59. *See* Harris, *supra* note 43, at 1197-98 ("[T]his chilling effect neutralizes the health benefits associated with medical information contained in the primary information sector and available to those providing direct patient care.").

60. Canfield v. Sandock, 563 N.E.2d 526, 529 (Ind. 1990) (quoting Collins v. Bair, 268 N.E.2d 95, 98 (Ind. 1971) (noting that if patients anticipate the possibility of disclosure of their private information, they may be reluctant, even inhibited, from sharing pertinent information of an embarrassing or otherwise confidential nature for fear of being publicly exposed)).

the nonparty's confidential medical records, even the threat of disclosure to the court via in camera inspection may discourage open and frank communication between patients and physicians and other care providers.[61]

The critical question that lies at the heart of the "chilling effect" on patient communications is whether people will in fact sacrifice their well-being if there is a lack of assurance of medical information confidentiality. One likely response is that many people fear ostracizism more than illness. Immediate concerns about gaining better health may bend to the fear of being shunned by society and denied opportunities to pursue personal and professional endeavors.[62] Thus, the salience of preserving medical information confidentiality is underscored by the destabilizing fear that many people experience at the threat of disclosure of intimate personal information.

III. Procedural Safeguard Measures of Nonparty Medical Records

A. Redaction of Names and Other Identifying Information

Many courts in the United States have been willing to allow the discovery of nonparty medical records if the defense (or moving party) establishes the records' relevancy and sufficient safeguards to protect nonparty's rights.[63] For example, in *Terre Haute Regional Hospital, Inc. v. Trueblood*,[64] a patient brought suit against a hospital for negligence after it reappointed a supervising surgeon who allegedly performed two unnecessary surgeries. The patient sought disclosure of nonparty medical records from the hospital in order to show a pattern of negligent behavior by the performing surgeon.[65] The Indiana Supreme Court held that redaction of the names and other identifying information from the nonparties' medical records was an adequate safeguard to protect the privacy interests of the nonparty patient.[66]

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61. *See* Poulin, *supra* note 15, at 1405; *see also* Young, *supra* note 27, at 930 ("When patients cannot be sure that the confidentiality of their medical records will not be maintained, they are less likely to be completely open and frank with a health care provider. This could result in the improper diagnosis and treatment of important health conditions . . . .").

62. *See* Orentlicher, *supra* note 56, at 82 ("Just as people dying with cancer may choose a better quality of life over a longer life, so may other people accept diminished health to preserve their privacy.").

63. *See* Hack & Schilmoeller, *supra* note 13, at 123 ("In 1996, the Supreme Court of Missouri joined other states allowing the discovery of a non-party's medical records if the movant established the records' relevancy to the issues involved in the case and provision was made for sufficient safeguards to protect the rights of non-parties as far as possible."); *see also* Lewin v. Jackson, 492 P.2d 406, 408 (Ariz. 1972); Balt. City Dep't of Soc. Servs. v. Stein, 612 A.2d 880, 891 (Md. 1992); State *ex rel.* Wilfong v. Schaeperkoetter, 933 S.W.2d 407 (Mo. 1996) (en banc); Beckwith v. Beckwith, 355 A.2d 537, 545 (D.C. 1976).

64. 600 N.E.2d 1358 (Ind. 1992).

65. *See id.* at 1359.

66. *See id.* at 1362.

In light of the ever-increasing advances in science and technology, defendants are casting their discovery nets wider among parties and nonparties alike in the hopes of reeling in enough information to construct alternative theories of causation, like genetics, environment, and influences in society, to explain the alleged harm caused to plaintiffs.[67] These advances have forced courts to conduct additional hearings and in camera inspections of privileged records to determine their relevancy, with the trial judge redacting the names and other identifying information from the records to preserve the privacy of the nonparty before the records are disclosed to the attorneys in the case.[68]

B. In Camera Inspection

Courts have traditionally used in camera inspection to protect the privacy interests of a nonparty.[69] For example, in *Palay v. Superior Court of Los Angeles*,[70] a mother filed a medical malpractice suit on behalf of her sixteen-month-old child against physicians for birth defects allegedly caused by their negligence. The mother sought a writ of mandate to compel the Superior Court of Los Angeles to vacate the defense's order requiring production of her medical records pertaining to prenatal care.[71] The court found that in camera review of the mother's medical records by her counsel and the trial judge accommodated the nonparty mother's confidentiality interests.[72]

C. Protective Order

Courts use protective orders as another tool to safeguard the privacy interests of nonparties who fear disclosure of the personal information contained in their medical records.[73] Protective orders provide safe harbor for nonparties whose private information is sought through discovery attempts that may be merely "fishing expeditions."[74] A protective order is "a uniquely effective management tool to prevent the unbridled dissemination of litigation information when that

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67. *See* Hack & Schilmoeller, *supra* note 13, at 125.

68. *See id.*

69. *See id.* During in camera inspection, the trial judge reviews the nonparty medical and other private information in the privacy of his or her chambers without counsel present to rule on the relevancy and admissibility of such information. *See id.*

70. 22 Cal. Rptr. 2d 839 (Ct. App. 1993).

71. *See id.* at 840.

72. *See id.* at 849.

73. Protective order is defined as "[a] court order prohibiting or restricting a party from engaging in a legal procedure (esp. discovery) that unduly annoys or burdens the opposing party or a third-party witness." BLACK'S LAW DICTIONARY 1239 (7th ed. 1999).

74. Penelope Potter Palumbo, Note, *Balancing Competing Discovery Interests in the Context of the Attorney-Client Relationship: A Trilemma*, 56 S. CAL. L. REV. 1115, 1135 (1983) (citations omitted) ("The party requesting discovery must show that the information sought is necessary and material. While the party seeking discovery of confidential information may prevail, the party compelled to disclose is often entitled to a protective order to safeguard confidential information.").

dissemination might be abusive and might interfere with the court's ability to resolve the case before it promptly."[75] Under Federal Rule of Civil Procedure 26(c), which governs protective orders, courts may, "[u]pon motion by a party or by the person from whom discovery is sought, . . . make any order which justice requires to protect a party or person from annoyance, embarrassment, oppression, or undue burden or expense."[76]

Upon granting a protective order, the court is obliged to define the terms of the release of confidential information with great precision, considering exactly who should have access to the data and for what purpose.[77] Essentially, a well-crafted protective order that "limits access to and the use and dissemination of the information is the most effective means of preserving an individual's privacy . . . while making [the information] available for legitimate litigation purposes."[78]

One significant fear that protective orders address is that, "[u]nlike tangible property, which can change hands without necessarily diminishing in value, information can never again be in the exclusive possession of its original owner once it is disclosed."[79] Protective orders are ideal mechanisms for minimizing the negative ramifications of modern discovery without eviscerating the value of the process.[80] For example, if trial judges could not exercise their discretion in issuing protective orders, the courts' only means of maintaining the privacy of the nonparty might be to deny discovery altogether, which would compromise the judicial process. Thus, the value of the protective order rests in its insulation of nonparties from the damaging consequences of discovery and continued facilitation of the discovery process.

IV. PROPERTY RIGHTS AS A POTENTIAL SAFEGUARD AGAINST DISCLOSURE

In the realm of informational privacy,[81] some scholars suggest that property

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75. Miller, *supra* note 3, at 463-64.

76. FED. R. CIV. P. 26(c). Types of protective measures include orders

> (1) that the disclosure or discovery not be had;
>
> (2) that the disclosure or discovery may be had only on specified terms and conditions, including a designation of the time or place;
>
> (3) that the discovery may be had only by a method of discovery other than that selected by the party seeking the discovery;
>
> (4) that certain matters not be inquired into, or that the scope of the disclosure or discovery be limited to certain matters.

Id.

77. *See* Miller, *supra* note 3, at 495.

78. *Id.* at 476.

79. *Id.* at 475.

80. *See id.* at 476; *see also* Seattle Times Co. v. Rhinehart, 467 U.S. 20, 35 (1984) (noting that litigants can abuse today's liberal discovery rules by "obtain[ing]—incidentally or purposefully—information that not only is irrelevant but if publicly released could be damaging to reputation and privacy").

81. *See* Mark A. Rothstein, *Genetic Secrets: A Policy Framework*, *in* GENETIC SECRETS,

rights are the best means for safeguarding an individual's privacy interest and serving the courts' truth-finding need.[82] Information, such as one's genetic code, sexual preference, credit history, and income, is deemed property.[83] The question posed to courts is who owns the property rights to such information.[84]

The field of law and economics offers valuable insight into how some courts might answer the question of ownership of information. Efficiency lies at the heart of a property rights approach to analyzing disclosure of nonparty medical and other information.[85] For example, a proponent of the law and economics approach may argue that as more accurate information is made available and is cheaper to obtain, "more beneficial transactions will occur. In the market context, if disclosure of information is inhibited, the decision to transact will be made either with second-rate information or with information obtained at a higher cost."[86] When applying this argument in the context of discovery of nonparty information, defendants would argue that if disclosure of accurate information pertaining to the issue in dispute is inhibited, there will be an efficiency loss due to the foreclosure of alternative theories of causation necessary to adequately represent their client.

Moreover, Paul M. Schwartz and Joel R. Reidenberg, professors of law at Brooklyn Law School and Fordham Law School respectively, conducted polls to elicit the views of American citizens toward protection of personal information.[87] These polls indicate that an overwhelming majority of Americans feel that their privacy is vulnerable and that a disclosure of private information to others is "conditioned on an implied, if not explicit, pledge to use the data only for that purpose."[88]

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supra note 6, at 451, 453 ("The essence of informational privacy is controlling access to personal information."); *see also* Orentlicher, *supra* note 56, at 79.

> Informational privacy is not only about shielding facts that might be viewed negatively by others, it is also about shielding facts that are generally viewed positively by others. Most fundamentally, informational privacy is valuable regardless of whether the information it shields is viewed positively or negatively by others. Informational privacy allows people to pursue their education, careers, friendships, romances, and medical care without the oversight, interference, or other unwelcome involvement of others. By controlling personal information, individuals can control the extent to which other people can participate in their lives.

Id.

82. *See* Richard S. Murphy, *Property Rights in Personal Information: An Economic Defense of Privacy*, 84 GEO. L.J. 2381, 2382 (1996).

83. *See id.* at 2383-84.

84. *See id.* at 2384.

85. *See id.* at 2385.

86. *Id.*

87. *See* PAUL M. SCHWARTZ & JOEL R. REIDENBERG, DATA PRIVACY LAW: A STUDY OF UNITED STATES DATA PROTECTION 155, 312-13 (1996).

88. Pamela Samuelson, *A New King of Privacy? Regulating Uses of Personal Data in the Global Information Economy*, 87 CAL. L. REV. 751, 768 (1999) (reviewing SCHWARTZ &

In response to concerns about the security of private information, economists have proposed granting individuals property rights in their personal information as a way to safeguard privacy interests.[89] Economists Carl Shapiro and Hal Varian understand concerns about privacy as "an externality problem: 'I may be adversely affected by the way people use information about me and there may be no way that I can easily convey my preferences to these parties.'"[90] Shapiro and Varian suggest that "[i]f individuals had property rights in information about themselves, they could convey their preferences to the market[,]" and this would give people some control, which they currently lack, over the disclosure of personal information.[91]

However, acknowledging property rights in medical information so as to protect the privacy interests of a nonparty has raised debate in the legal community.[92] Although little case law exists addressing this topic, *Moore v. Regents of the University of California*[93] prompted hot debate from the courtroom to the classroom. In *Moore*, medical researchers at the University of California at Los Angeles extracted spleen cells from Moore and later patented those cells for use in leukemia research.[94] Moore sued the university asserting a property right in his extracted cells in order to obtain a share of the potential profits from the patented cell line. The court held that Moore did not have property rights in his biological materials that were collected and used as part of the medical research and treatment.[95]

Protecting privacy of medical information through the creation of an ownership interest raises several problems in the context of discovery of nonparty medical information, including administrative burdens and, ironically, a surrender of confidentiality.[96] For instance, if property rights in medical information were recognized, there would be licensing and royalty implications if individuals were able to demand payment for the use of their private medical data.[97] If individuals had unlimited property rights in information about

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REIDENBERG, *supra* note 87; PETER P. SWIRE & ROBERT E. LITAN, NONE OF YOUR BUSINESS: WORLD DATA FLOWS, ELECTRONIC COMMERCE, AND THE EUROPEAN PRIVACY DIRECTIVE (1998)).

89. *See id.* at 770-71.

90. *Id.* at 770.

91. *Id.* at 770-71.

92. *See* David V. Foster & Erica Rose, *Protecting Medical Information: Complicated Legislative Challenges*, 8 EXPERIENCE 20, 47 (1998) ("A contentious issue included in some recent legislation is the creation of property rights in . . . medical information as a mechanism to protect privacy of medical information.").

93. 793 P.2d 479 (Cal. 1990).

94. *See id.* at 480-82.

95. *See id.* at 497.

96. *See* Foster & Rose, *supra* note 92, at 23.

97. *See id.*; *see also* Samuelson, *supra* note 88, at 772-73 ("There are also strong policy reasons for recognizing some spaces within which information should not be commodified. . . . First Amendment civil liberty and copyright policy values that favor certain kinds of free flows of information should be maintained . . . .").

themselves, they may become more resistant to defense attempts to discover such information, thereby impeding the truth-finding process.[98] Such action would arguably lead to impracticable administrative burdens on the courts in light of the increasing trend of requesting private medical and other records of nonparties in civil actions.

Furthermore, if nonparties attempt to exert property rights over their medical information, they would be forced to surrender their confidentiality.[99] For example, in order to track the use or disposition of particular medical information, the information would have to remain easily identifiable.[100] Clearly, it is difficult to reconcile this approach of vesting property rights in one's medical information to protect privacy with the inevitable loss of privacy that results from such an approach.[101]

The law and economics approach does not suggest that all limits on disclosure of private information are inefficient.[102] For instance, a nonparty's interest in avoiding embarrassment or some future disturbance from disclosure of personal information counts in the utility calculus that occurs under the law and economics approach.[103] Thus, limiting disclosure would be warranted whenever the nonparty's pure privacy interest outweighs the value of disclosure.[104] Moreover, an economic defense can be made for preserving personal privacy because people will likely be more willing to engage in activities that they would not have in the absence of anonymity if they feel secure that their private information will remain private.[105]

V. Constitutionally-Protected Privacy Right as a Potential Safeguard Against Disclosure

Aside from the law and economics perspective, a constitutionally-recognized right to privacy can also provide valuable insight into how nonparties may preserve their privacy interests. Although the word "privacy" is not found in the U.S. Constitution, privacy is deemed one of the most sacred and fundamental rights.[106] Notions of privacy can embody various forms, including individual autonomy, individual expectation of privacy as against third-party interests, and informational privacy.[107] Informational privacy lies at the heart of the issue of disclosure of nonparty medical and other private information. Professor Alan Westin, in his book *Privacy and Freedom*, defines privacy as "the claim of

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98. *See* Samuelson, *supra* note 88, at 773.
99. *See* Foster & Rose, *supra* note 92, at 23.
100. *See id.*
101. *See id.*
102. *See* Murphy, *supra* note 82, at 2385-86.
103. *See id.* at 2386.
104. *See id.* at 2387.
105. *See id.* at 2415-16.
106. *See* Alderman & Kennedy, *supra* note 4, at xiii.
107. *See* Harris, *supra* note 43, at 1202.

individuals, groups, or institutions to determine for themselves when, how, and to what extent information about them is communicated to others."[108]

Informational privacy is generally construed as a liberty interest.[109] The Fifth and Fourteenth Amendments' due process clauses protect liberty interests from unwarranted governmental intrusion.[110] The origin of U.S. Supreme Court jurisprudence on the right to privacy is *Griswold v. Connecticut*,[111] where the Court invalidated a state statute that criminalized the use of contraceptives.[112] The Court reached its decision by recognizing that certain constitutional "guarantees in the Bill of Rights have penumbras, formed by emanations from those guarantees that help give [the guarantees] life and substance," and that strongly imply a right to privacy.[113]

While the Court in *Griswold* held there to be a constitutionally-protected right to privacy, the Court, later in the landmark case of *Roe v. Wade*,[114] explicitly located the right to privacy in the due process clauses of the Fifth and Fourteenth Amendments.[115] Furthermore, the Court in *Roe v. Wade* limited the right of privacy to "fundamental" rights, such as marriage, procreation, contraception, family relations, child rearing and education.[116]

Although *Griswold* and *Roe* involved issues concerning the marital relationship and a woman's intimate decision-making power, respectively, the broad rationales of each decision concerned aspects of intimacy in interpersonal relations, communications and individual autonomy.[117] These same aspects bear on the issue of disclosure of nonparty medical information in that informational privacy involves an individual's ability to control private information. Recognizing the fundamental nature of confidentiality of medical information, California has amended its constitution to include among the inalienable rights of all people the right to pursue and obtain privacy.[118]

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108. ALAN F. WESTIN, PRIVACY AND FREEDOM 7 (1970).

109. *See* Francis S. Chlapowski, Note, *The Constitutional Protection of Informational Privacy*, 71 B.U. L. REV. 133, 135 (1991).

110. *See id.*

111. 381 U.S. 479 (1965) (invalidating a state law that prohibited the use and dissemination of information about the use of contraceptives).

112. *See id.* at 485-86; *see also* Carey v. Population Servs. Int'l, 431 U.S. 678, 692-99 (1977) (invalidating a state-wide ban on the sale of nonmedical contraceptives to minors); Eisenstadt v. Baird, 405 U.S. 438, 453-55 (1972) (emphasizing the personal and individual right to privacy to invalidate a statute that made contraceptives less available to unmarried couples).

113. *Griswold*, 381 U.S. at 484.

114. 410 U.S. 113 (1973).

115. *See id.* at 153 ("This right of privacy, whether it be founded in the Fourteenth Amendment's concept of personal liberty . . . as we feel it is, or, . . . in the Ninth Amendment's reservation of rights to the people, is broad enough to encompass a woman's decision whether or not to terminate her pregnancy.").

116. *See id.* at 152-53.

117. *See* Palay v. Superior Court of L.A., 22 Cal. Rptr. 2d 839, 847 (Ct. App. 1993).

118. "All people are by nature free and independent and have inalienable rights. Among these

Although the U.S. Constitution has not been amended to protect a right to informational privacy, the U.S. Supreme Court did address the issue of whether a state's information collection and data bank storage scheme violated individual privacy interests in *Whalen v. Roe.*[119] The Court in *Whalen* held, on the record before it, that the state's recording system did not violate any right or liberty interest protected by the due process clause of the Fourteenth Amendment and was therefore constitutionally valid.[120] Importantly, the Court reserved for future deliberation the question of whether comparable statutes lacking the privacy protections in New York's data collection scheme would violate privacy interests protected by the due process clause of the Fourteenth Amendment.[121] The *Whalen* Court recognized that the "privacy" safeguarded by the due process clause includes two distinct interests: freedom from disclosure of personal information and independence in making certain kinds of fundamental decisions.[122]

Subsequent to the *Whalen* decision, several circuit courts have disagreed as to whether the Court's articulation of a right to privacy encompassed a general right to nondisclosure of personal information.[123] For example, the Third and Fifth Circuits, among others, have agreed that *Whalen* identified a constitutionally protected interest for which a balancing test affords the most appropriate level of judicial review.[124] However, the Sixth Circuit has narrowly construed the language of the Court in *Whalen.*[125] In *J.P. v. DeSanti,*[126] the Sixth Circuit held that, although the United States Supreme Court recognizes a right to privacy, this right does not include a general right to confidentiality.[127]

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are . . . pursuing and obtaining safety, happiness, and privacy." CAL. CONST. art. I, § 1; *see also In re* Lifschutz, 467 P.2d 557 (Cal. 1970); *Palay*, 22 Cal. Rptr. 2d at 847.

> [T]he California Supreme Court held [in *In re* Lifschutz] that the confidentiality of the psychotherapeutic session falls within one such zone [of privacy]. Since that decision, the California Constitution has been amended to include among the inalienable rights of all people the right to pursue and obtain privacy . . . .

Jones v. Superior Court, 174 Cal. Rptr. 148, 157 (Cal. Ct. App. 1981). "The drive behind the constitutional amendment was an acknowledgment that '[f]undamental to our privacy is the ability to control circulation of information.'" *Id.* (quoting White v. Davis, 533 P.2d 222, 234 (Cal. 1975) (citing to statements made about the constitutional amendment)).

119. 429 U.S. 589 (1977).

120. *See id.* at 606.

121. *See id.* at 605-06.

122. *See id.* at 599-600 (The autonomy or decision-making strand of the Court's privacy formulation resembles the right to privacy discussions from *Griswold* and *Roe v. Wade.*).

123. *See* Chlapowski, *supra* note 109, at 146-49.

124. *See id.* at 147-48 (citing United States v. Westinghouse Elec. Corp., 638 F.2d 570 (3d Cir. 1980); Plante v. Gonzalez, 575 F.2d 1119 (5th Cir. 1978)).

125. *See id.* at 148.

126. 653 F.2d 1080 (6th Cir. 1981).

127. *See id.* at 1090; *see also* McElrath V. Califano, 615 F.2d 434, 441 (7th Cir. 1980); United States v. Choate, 576 F.2d 165, 181 (9th Cir. 1976), *cert. denied*, 439 U.S. 953 (1978).

Despite the split, the majority of cases have interpreted *Whalen* as "supporting the proposition that the right to privacy includes the right to informational privacy."[128]

VI. Recommendations

Disclosure of nonparty medical and other personal information in civil proceedings raises provocative considerations of two compelling and competing interests: defendants' due process concerns and nonparties' privacy interests in medical information confidentiality. Courts must engage in the delicate balancing of the competing interests.[129] Factors that courts should consider in determining whether disclosure of a nonparty's medical information is justified include: 1) the type of record requested; 2) the information the record does or does not contain; 3) the potential for harm in any subsequent nonconsensual disclosure; 4) the injury from disclosure to the relationship in which the record was generated; 5) the adequacy of safeguards to prevent unauthorized disclosure; 6) the degree of need for access; and 7) whether a recognizable public interest exists militating in favor of access.[130] In light of the potential for discrimination in employment and insurance coverage,[131] intimidation,[132] and the "chilling effect" on patient communications, courts should take into account the potential negative ramifications that may result from disclosure of sensitive personal information.[133]

Although establishing property rights as a mechanism to protect privacy of medical information seems advantageous, there are several problems in the creation of ownership interests in medical information. These problems include administrative burdens and a surrender of confidentiality.[134] For example, if property rights in medical information were recognized, and individuals were able to demand payment for the use of their private data, there would be problems of holdouts from licensing and royalty implications.[135] Such action would arguably lead to impracticable administrative burdens on the courts. Moreover, if a nonparty attempted to exert a property right over his or her medical information, the nonparty ironically would be forced to relinquish his or

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128. Chlapowski, *supra* note 109, at 149.

129. *See* United States v. Westinghouse Elec. Corp., 638 F.2d 570, 578 (3rd Cir. 1980) (holding that a minimal intrusion into the privacy surrounding employees' medical records was justified and the employer could not give a blanket refusal to the National Institute for Occupational Safety and Health in its attempts to disclose such records, but noting that since there might be highly sensitive information contained in particular files, the Institute was required to give prior notice to employees and to allow them to raise personal claims of privacy).

130. *See id.*

131. *See* Powers, *supra* note 6, at 357.

132. *See* Samborn, *supra* note 1, at 29.

133. *See* Harris, *supra* note 43, at 1197-98.

134. *See* Foster & Rose, *supra* note 92, at 23.

135. *See id.*

her confidentiality.[136] For instance, in order to track the use and disposition of certain medical data, the information would have to remain easily identifiable.[137] Thus, it would be virtually impossible to reconcile this approach of establishing property rights in one's medical information to protect privacy when such action would lead inevitably to a loss of privacy.[138]

A constitutionally recognized right to privacy provides more compelling insight into how the privacy interests of nonparties may be preserved. The landmark cases of *Griswold v. Connecticut*[139] and *Roe v. Wade*[140] are instructive on the issue of disclosure of nonparty medical information. The Court's broad rationales concerned similar aspects of intimacy in interpersonal relations, communications, and individual autonomy.[141] Moreover, they involve an individual's ability to control his or her private information, which is threatened by defense attempts to disclose that information in discovery proceedings.

Even though some uncertainty may exist regarding the protection afforded to a nonparty's medical information under a constitutional rights approach, such an approach coupled with traditional safeguards, such as protective orders and in camera review, offers the most protection to a nonparty's interest in medical information confidentiality. The seeds for a constitutional right to informational privacy have already been planted in U.S. Supreme Court jurisprudence by *Griswold v. Connecticut*,[142] *Roe v. Wade*,[143] and *Whalen v. Roe*.[144] In each case, the Supreme Court rested its decisions on the notion of individual autonomy,[145] which is closely related to an individual's ability to control his or her private information.

With a constitutional right to informational privacy, a nonparty may feel more secure in the preservation of privacy of his or her medical information because a defendant attempting to disclose the private information of a nonparty will have to overcome a high level of scrutiny. That is, a defendant will have to show that the information sought serves a compelling interest and that there are no less restrictive means to accomplish that interest.[146]

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136. *See id.*
137. *See id.*
138. *See id.*
139. 381 U.S. 479 (1965).
140. 410 U.S. 113 (1973).
141. *See* Palay v. Superior Court of L.A., 22 Cal. Rptr. 2d 839, 847 (Ct. App. 1993).
142. 381 U.S. at 479.
143. 410 U.S. at 113.
144. 429 U.S. 589 (1977).
145. *See Palay*, 22 Cal. Rptr. 2d at 847.
146. This high level of scrutiny is also encompassed in Federal Rule of Civil Procedure 26 governing disclosure, which states that:

> [A] party may obtain discovery of documents and tangible things otherwise discoverable under subdivision (b)(1) of this rule . . . only upon a showing that the party seeking discovery has substantial need of the materials . . . and that the party is unable without undue hardship to obtain the substantial equivalent of the materials by other means.

In conjunction with a constitutionally recognized right to informational privacy, courts should adopt a balancing approach that applies the various factors enunciated in *United States v. Westinghouse Electric Corp.*[147] on an ad hoc basis to determine whether nonparty medical records should be disclosed. A balancing approach would allow courts to determine whether "disclosure would cause the harm addressed by the privilege or whether the goals of the privilege can be served without frustrating litigation fairness."[148] In light of the compelling interests on both sides—the defense interests in due process on the one hand, and the nonparty's interest in protecting the privacy of his or her medical information on the other—a middle ground seems to serve both interests. Under a balancing approach, a court "can factor in the parties' intransigence and the availability of a solution that provides the essential information with the least loss of privacy."[149]

Moreover, courts employing the balancing approach may also utilize the traditional methods of safeguarding the privacy interests of a nonparty: redaction of names and other identifying information, in camera review, and protective orders. The value of a constitutional right to informational privacy, protective orders and in camera review rests upon their usefulness in insulating nonparties from the potential damaging consequences of discovery while still facilitating the truth-finding process. Within the sanctity of the judge's chambers, there is an assurance of protection of the privacy interests of the nonparty as well as the due process interests of the defense given that the court is the only neutral participant in the litigation proceedings.[150]

Trial judges may exercise their discretion in each case by weighing the relative threats to privacy against the relative threats to due process of the defendant. Judges may also draft with careful precision the terms of release of confidential information, identifying exactly who should have access to the data and for what purpose.[151] In addition to in camera proceedings and protective orders, courts should also exercise their injunctive powers to prevent the use of

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FED. R. CIV. P. 26(b)(3).

147. 638 F.2d 570, 578 (3d Cir. 1980) (Factors include "the type of record requested, the information it does or might contain, the potential for harm in any subsequent nonconsensual disclosure, the injury from disclosure to the relationship in which the record was generated, the adequacy of safeguards to prevent unauthorized disclosure, the degree of need for access, and whether" any recognizable public interest exists militating in favor of access.).

148. Poulin, *supra* note 15, at 1370.

149. *Id.*

150. *See* Miller, *supra* note 3, at 501.

> Courts should continue to use their discretion to protect parties' legitimate litigation, privacy, and property interest, and the parties should retain their rights to negotiate protective and sealing agreements voluntarily, subject to judicial veto in the exceptional case. This practice seems wise [since], . . . on the whole, judges appear to have exercised this authority appropriately in the past . . . .

Id.

151. *See id.* at 495.

any confidential information beyond litigation if nonparties still feel uneasy about the disclosure of their personal information.[152] Courts may further protect confidential information by ordering the omission of details from the published opinion.[153]

CONCLUSION

Thus, under the proposed approach, the next time a parent decides to file a civil suit on behalf of his or her child, the parent may rest more soundly knowing that his or her personal, intimate information will not be so easily swept up in the discovery net cast by defendants.[154] Yet, defendants may still take full advantage of the liberal rules governing disclosure within the constitutional bounds of informational privacy in order to fully and fairly represent their clients. Although these proposals for safeguarding the privacy interests of nonparties may not address all of the problems that can arise in discovery proceedings, they may constitute a substantial step toward adequately serving the privacy interests of nonparties while facilitating the truth-finding process.

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152. *See* Palumbo, *supra* note 74, at 1138-39.
153. *See id.* at 1137.
154. *See id.* at 1139.

ERISA DISCLOSURE DECISIONS: A PYRRHIC VICTORY FOR DISCLOSURE ADVOCATES

EUGENE P. SCHULSTAD*

INTRODUCTION

A primary goal of Congress when it passed the Employee Retirement Income Security Act of 1974 ("ERISA" or "Act") was to protect the interests of pension plan participants and their beneficiaries.[1] Congress recognized, however, that the voluntary nature of private retirement plans made it necessary to balance requirements placed on employers against the burdens of plan administration.[2] Congress hoped that by achieving such a balance there would be an overall increase both in the number of retirement plans and in the number of employees entitled to receive employee retirement benefits.[3] Contrary to Congress' intent, however, the combined burdens placed on employers by the passage of ERISA and subsequent court decisions have caused considerable tension between the needs of businesses and the desires of plan participants.[4]

One area that typifies this tension is disclosure. For example, a common source of disputes between employers and plan participants arises when modifications to pension and other benefit plans are under consideration.[5] Questions inevitably arise regarding what information must be communicated to plan participants as plan changes are contemplated.[6] Circumstances under which disclosure issues surface include communication of the health care benefits available under a plan, the procedures that must be followed to take advantage of benefits, and what information should be disclosed when a company converts from one type of retirement plan to another. A typical disclosure case in litigation concerns a retirement decision in which an employee opted for early retirement and later learned that his employer was considering a retirement incentive program that would have resulted in increased pension benefits for the employee had retirement been delayed.[7]

The statutory requirements of ERISA that address disclosure are largely

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1. *See* 29 U.S.C. § 1001(b) (1999) ("[T]he policy of this chapter [is] to protect . . . the interests of participants in employee benefit plans and their beneficiaries . . . .").

2. *See* H.R. REP. NO. 93-533, pt. 1, at 1 (1974), *reprinted in* 1974 U.S.C.C.A.N. 4639, 1973 WL 12549.

3. *See id.*

4. *See* Mary O. Jensen, Note, *Separating Business Decisions and Fiduciary Duty in ERISA Litigation?*, 10 BYU J. PUB. L. 139, 140 (1996).

5. *See* Ryan P. Barry, Comment, *ERISA's Purpose: The Conveyance of Information from Trustee to Beneficiary*, 31 CONN. L. REV. 735, 736 (1999).

6. *See id.* at 736-37.

7. *See* Bins v. Exxon Co. U.S.A., 189 F.3d 929, 931 (9th Cir. 1999), *rev'd en banc*, 220 F.3d 1042 (9th Cir. 2000).

confined to the plan administrator's reporting duties to plan participants and government regulators and therefore do not directly address the issue of precisely what communications are required and when they must be made.[8] These reporting obligations include providing participants with summary plan descriptions written in a manner that the average plan participant can understand, filing annual reports with the Internal Revenue Service, and distributing summary annual reports to participants.[9] Under ERISA, a plan administrator is a fiduciary, and as such owes a fiduciary duty to participants to disclose the information required by the Act.[10] A "fiduciary" is defined under ERISA as a person who exercises control over management of a plan or disposition of plan assets, who gives investment advice for compensation with respect to the plan, or who has discretionary authority or responsibility for administration of the plan.[11] Early court decisions interpreted ERISA narrowly, holding that the fiduciary duties of a plan administrator were only those specific reporting and disclosure obligations outlined in ERISA.[12] Subsequent decisions, however, have expanded the fiduciary duties of plan administrators relating to disclosure far beyond the specific reporting mandates of ERISA. The Sixth Circuit Court of Appeals, for instance, found that plan administrators have an affirmative duty not to mislead or misrepresent plan participants when material changes to a plan are under consideration.[13] Expanding on that decision, the Third Circuit held that a misrepresentation was "material" if contemplated changes to a plan were under "serious consideration."[14] Other courts have reached similar conclusions and held that if an employee asks his employer whether plan changes are being considered, and in fact such changes are under serious consideration, the employer has a fiduciary obligation to disclose that fact.[15] These decisions have added to the regulatory burdens of ERISA and therefore have contributed to the steady decline in the number of traditional pension plans being offered to employees.[16]

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8. *See* 29 U.S.C. § 1021 (1999).

9. *See id.* §§ 1024-1025.

10. *See id.* § 1104.

11. *Id.* § 1002(21)(A).

12. *See* Acosta v. Pac. Enters., 950 F.2d 611, 619 (9th Cir. 1992) (indicating requested disclosures were not "sufficiently related to the provision of benefits or the defrayment of expenses," which were the purposes of ERISA); *see also* Porto v. Armco, Inc., 825 F.2d 1274, 1275 (8th Cir. 1987), *cert. denied*, 485 U.S. 937 (1988). A plan administrator who meets ERISA's statutory deadlines for disclosure does not breach his fiduciary duty by not making earlier disclosures. See 29 U.S.C. § 1021 for specific disclosure requirements.

13. *See* Berlin v. Mich. Bell Tel. Co., 858 F.2d 1154, 1163-64 (6th Cir. 1988).

14. Fischer v. Phila. Elec. Co., 994 F.2d 130, 135 (3d Cir. 1993).

15. *See* McAuley v. IBM, 165 F.3d 1038, 1043 (6th Cir. 1999); Vartanian v. Monsanto Co., 131 F.3d 264, 268 (1st Cir. 1997). *But see* Pocchia v. NYNEX Corp., 81 F.3d 275, 278 (2d Cir. 1996), *cert. denied*, 519 U.S. 931 (1996) (holding plan administrators have no duty to disclose contemplated changes until a plan is actually amended).

16. *See* Colleen T. Congel & Elizabeth A. White, *Advisory Council: Consensus on CB*

Although the ruling has since been reversed, a three-judge panel of the Ninth Circuit recently attempted to significantly extend ERISA's disclosure requirements.[17] In *Bins v. Exxon*, an employee of Exxon asserted that he would have delayed his retirement had he known that the company was considering a change to its pension plan that would have resulted in increased retirement compensation for him.[18] Arguably, the court could have chosen to find in favor of the employee on the basis that the plan was under serious consideration when he made his inquiry.[19] The Ninth Circuit panel instead opted to expand ERISA disclosure requirements even further than prior decisions in holding that a company has a fiduciary duty to affirmatively disclose the fact that it is seriously considering a change to its pension plan to all potentially affected plan participants whether or not participants have inquired about the prospects of such a change.[20] The panel's ruling conflicts with disclosure decisions of other circuits, none of which had previously required such a broad affirmative duty of disclosure under ERISA.[21] Although the Ninth Circuit reversed this decision en banc, the panel's holding indeed reflects the views of recent commentators who suggest that ERISA's fiduciary duty requires affirmative disclosure even without participant inquiry.[22]

This Note contends that courts' disclosure decisions have decreased the availability of traditional pension plans to employees, thus defeating the

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Conversions Unlikely; IBM Official Defends Company's Actions, BNA PENSION & BENEFITS DAILY NEWS, Sept. 10, 1999, at D3 (the Pension Benefit Guaranty Corporation (PBGC) reported that the number of defined benefit retirement plans it insures has dropped from 114,000 to 45,000 since 1985); *see also* Thomas Lee, *A Dying Plan*, INDIANAPOLIS STAR, June 12, 2000, at D1 (according to the PBGC the number of traditional pension plans has now fallen to 40,000 and the number of actual workers covered by plans decreased from 27.3 million to 22.6 million from 1988 to 1996); *ERISA's Requiem*, PENSIONS & INVESTMENTS, Sept. 6, 1999, at 10 (editorial) ("Spooked by ERISA's requirements, companies terminated 5,000 defined benefit plans in the first nine months after the law was passed.").

17. *See* Bins v. Exxon Co. U.S.A., 189 F.3d 929, 931 (9th Cir. 1999), *rev'd en banc* 220 F.3d 1042 (9th Cir. 2000).

18. *See id.* at 932.

19. *See id.* at 940.

20. *See id.* at 939.

21. *See* McAuley v. IBM, 165 F.3d 1038, 1043 (6th Cir. 1999) (holding that employers cannot make either intentional or negligent misrepresentations if a plan change is under serious consideration); Pocchia v. NYNEX Corp., 81 F.3d 275, 278 (2d Cir. 1996), *cert. denied*, 519 U.S. 931 (1996) (finding no duty to disclose changes before they are adopted); Fischer v. Phila. Elec. Co., 994 F.2d 130, 135 (3d Cir. 1993) (holding that employer cannot mislead if a plan change is under serious consideration). In a companion case decided the same day as *Bins*, the Ninth Circuit panel applied the "affirmative duty to disclose rule" announced in *Bins*, holding that Pacific Bell breached its fiduciary duty to certain employees who took early retirement by not disclosing that it was seriously considering a more favorable program. *See* Wayne v. Pac. Bell, 189 F.3d 982, 989 (9th Cir. 1999).

22. *See generally* Barry, *supra* note 5, at 2; Jensen, *supra* note 4, at 2.

balancing intent of Congress in establishing ERISA.[23] Court decisions such as the Ninth Circuit panel's holding in *Bins*, that attempt to expand disclosure requirements beyond those set forth in ERISA, only contribute to the rate of decline in the number of traditional benefit plans being offered. Although ERISA covers employee benefit plans other than pension plans, this Note focuses on courts' disclosure decisions as they relate to employee retirement decisions.[24] Disclosure cases discussing other employee benefit plans will be reviewed only to the extent that they have been relied upon by courts in making disclosure decisions involving retirement benefits.[25]

Part I of the Note reviews the purpose and background of ERISA. The discussion sets forth the fiduciary duties, disclosure requirements, and enforcement schemes established by ERISA. Part II outlines the history of circuit courts of appeals' disclosure decisions under ERISA and how the courts have incrementally increased the disclosure burdens on businesses over time. Part III examines how changes dictated by the competitive needs of business clash with the fiduciary requirements under ERISA as developed and expanded by the courts. Part III then concludes by demonstrating how court rulings have apparently influenced company decisions with respect to pension plan offerings. Part IV analyzes the initial *Bins* decision and compares it with the holdings of other circuits, contains a critique of *Bins*, and discusses disclosure alternatives that would more appropriately balance the needs of employers and plan participants. Part V addresses the need for a resolution of the current split in circuit court views concerning disclosure under ERISA so that the balance between business needs and the protection of plan participants originally envisioned by Congress can be restored.

I. ERISA

A. Origin

The growth in private pension plans was spawned by dissatisfaction with government retirement plans (i.e., the Social Security Act and the Railroad Retirement Act) that existed in the 1940s and by employers' recognition of a responsibility for their employees' welfare beyond retirement.[26] Experience demonstrated that existing regulations were unable to adequately protect the rights of workers with respect to their employers' pension plans.[27] Many employees were reaching retirement age only to find that promised retirement

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23. *See* 29 U.S.C. § 1001 (1999); *see also* Barry, *supra* note 5, at 2.

24. *See* 29 U.S.C. § 1002(1) (2000). Plans other than pension plans are generally referred to as welfare benefit plans, and include health and disability benefit plans.

25. *See* Bixler v. Cent. Pa. Teamsters Health & Welfare Fund, 12 F.3d 1292 (3d Cir. 1993); Eddy v. Colonial Life Ins. Co., 919 F.2d 747 (D.C. Cir. 1990).

26. *See* H.R. REP. NO. 93-533, pt. 2, at 2 (1974) (providing background), *reprinted in* 1974 U.S.C.C.A.N. 4639, 1973 WL 12549.

27. *See id.* at 4.

funds were nonexistent either because of improper funding by the employer or because the company was in financial trouble.[28] ERISA was enacted in 1974 to provide for disclosures and safeguards "with respect to the establishment, operation, and administration" of retirement plans.[29]

B. Purpose of ERISA

Congress' main purpose in enacting ERISA was "to ensure that workers receive promised pension benefits upon retirement."[30] To achieve this goal, Congress established statutory procedures in ERISA to regulate plan funding and required that participants' benefits become nonforfeitable upon normal retirement age.[31] ERISA also established minimum standards of fiduciary conduct[32] for those administering retirement plans and for "public disclosure of the plan's administrative and financial affairs."[33] To enable plan participants to enforce their rights under ERISA, including its disclosure and reporting requirements, Congress provided them access to the federal courts.[34] However, Congress also recognized that because employers are not required to offer retirement plans, it is important that employers be able to administer plans with reasonable expense so that they are not discouraged from establishing or continuing such plans.[35]

C. Fiduciary Duties

ERISA's fiduciary duties are based on the common law of trusts, which governed most benefit plans before ERISA's enactment.[36] However, the U.S. Supreme Court in *Varity Corp. v. Howe* instructed that trust law is only a "starting point" and that courts must determine when the purposes of ERISA depart from trust law requirements under the common law.[37] ERISA specifies that a fiduciary will use a "[p]rudent man standard of care" and will "discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries."[38] A fiduciary must also act "for the exclusive purpose of: (i) providing benefits to participants and their beneficiaries; and (ii) defraying

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28. *See id.* at 5.

29. 29 U.S.C. § 1001(a) (1999).

30. Dade v. N. Am. Philips Corp., 68 F.3d 1558, 1562 (3d Cir. 1995) (quoting Hoover v. Cumberland, Md. Area Teamsters Pension Fund, 756 F.2d 977, 985 (3d Cir. 1985)); *see also* 29 U.S.C. § 1001 (1999).

31. *See* 29 U.S.C. § 1001.

32. *See id.* § 1104.

33. H.R. REP. NO. 93-533, pt. 7, at 17 (1974), *reprinted in* 1974 U.S.C.C.A.N. 4639, 1973 WL 12549.

34. *See* 29 U.S.C. § 1001(b).

35. *See id.* § 1104(a)(1)(A)(ii).

36. *See* Varity Corp. v. Howe, 516 U.S. 489, 496 (1996).

37. *Id.* at 497.

38. 29 U.S.C. § 1104(a)(1) (1999).

reasonable expenses of administering the plan."[39] The Act also generally requires a fiduciary to exercise prudence by diversifying plan investments to minimize risk, unless it is prudent not to do so, and to manage the plan in accordance with the instruments governing the plan.[40]

D. Disclosure Requirements Under ERISA

The disclosure and reporting requirements specified under ERISA are generally administrative and regulatory in nature.[41] The requirements include a duty to provide participants and beneficiaries with summary descriptions of plans, financial reports, and other plan information, some automatically and others on request by a participant.[42] Certain filings with the government, such as annual reports or premium payment records to the Pension Benefit Guaranty Corporation ("PBGC"), are also required.[43] Such reporting was seen as a means to provide employees and the government with enough information to know whether the plan was being properly administered with financial integrity.[44] In short, reporting requirements were intended to provide employees with enough information to reveal what benefits will be received, what procedures must be followed, who is responsible for the plan, and whether the plan is adequately funded.[45]

E. Enforcement

ERISA contains specific enforcement procedures allowing plan participants to bring private actions for violations of the Act in order to recover benefits, enforce rights under the plan, or clarify future rights.[46] Beyond those specific requirements, Congress noted that "a body of Federal substantive law will be developed by the courts to deal with issues involving rights and obligations under private welfare and pension plans."[47] Prior to *Varity*, courts had held that remedies were to be attributed only to the benefit plan at issue, but the Court held in *Varity* that ERISA's remedial provisions authorize lawsuits for individual relief.[48]

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39. *Id.*

40. *See id. But see* 29 U.S.C. § 1104(c)(1) (stating that if a participant is allowed to exercise control over investments in his account and chooses to do so, the fiduciary will not be liable for any loss in the account).

41. *See* 29 U.S.C. § 1021.

42. *See id.*

43. *See id.*

44. *See* H.R. REP. NO. 93-533, pt. 6, at 11 (1974), *reprinted in* 1974 U.S.C.C.A.N. 4639, 1973 WL 12549.

45. *See* Porto v. Armco, Inc., 825 F.2d 1274, 1276 (8th Cir. 1987), *cert. denied*, 485 U.S. 937 (1988).

46. *See* 29 U.S.C. § 1132(a).

47. 129 CONG. REC. 29,942 (1974) (remarks of Sen. Jacob Javits).

48. *See* Varity Corp. v. Howe, 516 U.S. 489, 507 (1996).

F. Competing Interests—Individual Rights and Business Needs

Congress was constrained in its desire to statutorily protect individual benefit rights through regulation because pension plans are voluntary.[49] The desire to protect participants' rights was countered by a desire that employers adopt new plans and expand the coverage of their existing plans so that a greater number of employees would receive retirement benefits.[50] The Supreme Court recognized these concerns in *Varity*, noting that courts may have to take into account competing congressional interests, such as Congress' desire to protect employee benefits versus its concern about creating a system so complex and costly that employers are discouraged from establishing employee benefit plans.[51] Despite Congress' stated intent, however, it was evident early on that the complexities of ERISA administrative regulations were "unduly burdensome" to businesses.[52]

II. THE PROGRESSION OF DISCLOSURE DECISIONS UNDER ERISA

A. The Statutory Duties of ERISA

The first court decisions to address disclosure held that there was no fiduciary duty to disclose beyond the specific statutory requirements outlined in ERISA.[53] For example, in *Porto v. Armco, Inc.*, a retired employee sued the plan administrator and his employer claiming that he should have been informed of an amendment to a benefit plan at the same time active employees were informed of the change in the plan. He had been informed of the change, however, within the statutory limits of ERISA.[54] The Eighth Circuit held that a plan administrator who complies with ERISA's disclosure standard cannot be said to have breached the fiduciary duty.[55] Furthermore, in *Acosta*, the plan participant was employed by a subsidiary of the appellee and participated in the subsidiary's retirement plan.[56] The employee claimed that the company breached its fiduciary duty

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49. *See* H.R. REP. NO. 93-533, pt. 1, at 1 (1974), *reprinted in* 1974 U.S.C.C.A.N. 4639, 1973 WL 12549.

50. *See id.*

51. *See Varity Corp.*, 516 U.S. at 497; *see also* Vineeta Anand, *A History of Good Intentions Gone Awry*, PENSION & INVESTMENTS, Sept. 6, 1999, at 19 (quoting remarks of Rep. Al Ullman). "This legislation provides urgently needed reform in the pension area. But at the same time, it continues the basic governmental policy of encouraging the growth and development of voluntary private pension plans." *Id.*

52. Reorg. Plan No. 4 of 1978, 43 Fed. Reg. 47,713 (Aug. 10, 1978), *reprinted in* 29 U.S.C. § 1001 (1999) (Letter from President Carter describing a plan intended to reduce the administrative burdens and complexity of ERISA).

53. *See* Acosta v. Pac. Enters., 950 F.2d 611, 619 (9th Cir. 1992); Porto v. Armco, Inc., 825 F.2d 1274, 1276 (8th Cir. 1987).

54. *See Porto*, 825 F.2d at 1274-75.

55. *See id.* at 1276.

56. *See Acosta*, 950 F.2d at 615.

under ERISA because it refused to provide the employee with names and addresses of all plan participants, which the employee wanted in order to solicit votes for an individual he favored for a director's position on the company's board.[57] The Ninth Circuit in *Acosta* agreed with the Eighth Circuit, holding that the employee's requested disclosure was not "sufficiently related to the provision of benefits or the defrayment of expenses" to be mandated under ERISA and therefore no disclosure was required.[58]

B. Fiduciary Duty Not to Mislead or Misrepresent

A number of courts deciding disclosure issues moved quickly beyond a mere statutory interpretation of the disclosure requirements of ERISA and began interpreting the scope of a plan administrator's duty to disclose under the auspices of the common law of trusts.[59] Court decisions informed by the law of trusts that have focused on the plan administrator's general fiduciary duties under ERISA have increasingly interpreted those duties in favor of plan participants. Early decisions recognized a fiduciary duty to "speak truthfully" to plan participants.

In *Berlin v. Michigan Bell Telephone*,[60] employees contended that Michigan Bell intentionally misled them by indicating that the company was not considering an enhanced early retirement package and that employees should therefore not delay their retirement decisions.[61] The Sixth Circuit held that the company's actions constituted a breach of fiduciary duty in affirmatively misrepresenting the plan terms to plan participants.[62] In 1996, the Second Circuit in *Pocchia v. NYNEX Corp.* agreed with the Sixth Circuit and noted that it is "well-settled that plan fiduciaries may not affirmatively mislead plan participants about changes, effective or under consideration, to employee pension benefit plans."[63]

In *Varity Corp. v. Howe*, the Supreme Court weighed in on the subject of misrepresentation, holding that "deceiving a plan's beneficiaries in order to save the employer money at the beneficiaries' expense is not to act 'solely in the interest of the participants and beneficiaries'" and is therefore a breach of the employer's fiduciary duty under ERISA.[64] The egregious employer behavior in *Varity* involved employees being told that if they agreed to voluntarily transfer

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57. *See id.*

58. *Id.* at 619.

59. For further discussion of fiduciary duties under the common law of trusts, see Barry, *supra* note 5, at 741-43. *See also* Jensen, *supra* note 4, at 145-49.

60. 858 F.2d 1154 (6th Cir. 1988).

61. *See id.* at 1158.

62. *See id.* at 1163.

63. 81 F.3d 275, 278 (2d Cir. 1996). *See also* Mullins v. Pfizer, Inc., 23 F.3d 663, 669 (2d Cir. 1994); Fischer v. Phila. Elec. Co., 994 F.2d 130, 135 (3d Cir. 1993); Drennan v. Gen. Motors Corp., 977 F.2d 246, 251 (6th Cir. 1992), *cert. denied*, 508 U.S. 940 (1993).

64. 516 U.S. 489, 506 (1996) (quoting 29 U.S.C. § 1021).

to a new company formed by Varity, their benefits would remain secure when, in fact, Varity knew that the newly formed company was insolvent when it was created.[65] When the new company went into receivership during its second year of operation, the employees who had transferred to it lost all of their non-pension benefits.[66] The Supreme Court agreed with the district court that Varity's communications to its employees concerning the security of their benefits were materially misleading and therefore a violation of Varity's fiduciary duty.[67]

In *Anweiler v. American Electric Power Service Corp.*,[68] the Seventh Circuit found that silence could also be misleading and constitute a breach of fiduciary duty under ERISA. In *Anweiler*, an employee was asked by his insurer to sign a reimbursement agreement that made the insurer a beneficiary under the employee's group life insurance policy. The request was made because Anweiler had been receiving disability benefits in excess of what he was owed.[69] The Seventh Circuit found that because the employee was informed neither that it was unnecessary for him to sign the agreement in order to receive his long-term disability benefits nor that the agreement was revocable at will, the company breached its fiduciary duty to the employee.[70]

C. Materiality

Not all misrepresentations are necessarily material, and only material misrepresentations constitute a breach of fiduciary duty. The issue of materiality was addressed by the Third Circuit in *Fischer v. Philadelphia Electric Co.*[71] In *Fischer*, the court linked materiality to the degree of seriousness with which a change to a plan is being considered.[72] Employees in *Fischer* complained that they took early retirement because they received assurances from company representatives that no enhanced early retirement plans were under consideration.[73] The company argued that the plan counselors were telling employees the truth because the company had never told the counselors it was considering a new plan. The *Fischer* court did not accept this argument and instead held that the company's fiduciary obligations "cannot be circumvented by building a 'Chinese wall' around those employees on whom plan participants reasonably rely for important information and guidance about retirement."[74] The court went on to instruct that the "more seriously a plan change is being

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65. *See id.* at 494.

66. *See id.*

67. *See id.* at 505.

68. 3 F.3d 986, 991 (7th Cir. 1993).

69. *See id.* at 989.

70. *See id.* Despite the court's holding, the plaintiff received no remedy as the employer had already paid out more than the beneficiary was due under the plan. *See id.* at 994.

71. 994 F.2d 130 (3d Cir. 1993).

72. *See id.* at 135.

73. *See id.*

74. *Id.*

considered, the more likely a misrepresentation, e.g., that no change is under consideration, will pass the threshold of materiality."[75]

The case was reviewed a second time by the Third Circuit after the district court found on remand that the company was in fact seriously considering an early retirement program at the same time employees were requesting information about such programs.[76] In *Fischer II*, the court offered a formulation that "[s]erious consideration of a change in plan benefits exists when (1) a specific proposal (2) is being discussed for purposes of implementation (3) by senior management with the authority to implement the change."[77] Applying this three-pronged test, the Third Circuit held that none of the plaintiffs were materially misinformed after the earliest date at which the retirement plan was being seriously considered.[78] Given a similar set of facts, the First Circuit held that there was no fiduciary duty of disclosure when an employee inquired about plan changes because the changes were not under serious consideration at the time of inquiry.[79]

The Second Circuit took the *Fischer II* "serious consideration test" even further in *Ballone v. Eastman Kodak Co.*, holding that employers cannot mislead employees by making statements about a plan that they know are false *whether or not* they are seriously considering altering the plan.[80] In another case dealing with early retirement issues, *McAuley v. IBM*, the Sixth Circuit applied the *Fischer II* test to determine that communications to employees were made at a time plan when changes were under "serious consideration" by management. The court remanded the case to determine if the representations were materially misleading.[81] The Supreme Court, on the other hand, specifically declined to consider the validity of the "serious consideration test" in *Varity*.[82]

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75. *Id.* The case was remanded to the district court to determine if the changes were being seriously considered when the employee requests were made. *See id.* at 136.

76. *See* Fischer v. Phila. Elec. Co., 96 F.3d 1533 (3d Cir. 1996), *cert. denied*, 520 U.S. 1116 (1997). This case is referred to in subsequent cases as *Fischer II*. *See* Vartanian v. Monsanto Co., 131 F.3d 264, 268 (1st Cir. 1997).

77. 96 F.3d at 1539.

78. *See id.* at 1544.

79. *See Vartanian*, 131 F.3d at 272.

80. 109 F.3d 117, 126 (2d Cir. 1997).

81. McAuley v. IBM, 165 F.3d 1038, 1043-47 (6th Cir. 1999). The Sixth Circuit disagreed with the district court as to the date that serious consideration of the early retirement plan had begun and remanded the case. IBM subsequently reached a settlement with its former employees. *See* Jon G. Auerbach & Ellen E. Schultz, *IBM Settles Pension Suit at $15.5 Million*, WALL ST. J., Sept. 14, 1999, at B14.

82. *See* Varity Corp. v. Howe, 516 U.S. 489, 506 (1996) ("[W]e need not reach the question whether ERISA fiduciaries have a fiduciary duty to disclose truthful information on their own initiative, or in response to employee inquiries.").

D. Voluntary Duty to Disclose

Although most of the circuit courts have embraced the "serious consideration test" as it applies to disclosure in response to inquiries by plan participants, the courts' differences are more pronounced on the issue of whether a fiduciary duty to *voluntarily* disclose information exists. The D.C. Circuit in *Eddy v. Colonial Life Insurance Co.*[83] applied the Restatement (Second) of Trusts section 173 to find that "[r]egardless of the precision of his questions, once a beneficiary makes known his predicament, the fiduciary 'is under a duty to communicate . . . all material facts in connection with the transaction which the trustee knows or should know.'"[84] The Seventh Circuit in *Anweiler* also found a breach of fiduciary duty where the company did not provide its employee complete information at the appropriate time.[85] The *Anweiler* court held there was an affirmative duty to communicate facts concerning employee rights whether or not a beneficiary asks the fiduciaries for information.[86]

The Second Circuit established a bright line rule in *Pocchia v. NYNEX Corp.*, holding that a fiduciary does not have a duty under ERISA to "voluntarily disclose changes in a benefit plan before they are adopted."[87] In *Pocchia,* although changes to the company's retirement plan were announced several months after the employee's retirement, he contended that the company had already decided to implement a new plan when he was negotiating his retirement, and that he should have been informed at that time.[88] The *Pocchia* court recognized that the uncertainty faced by employers if such a disclosure rule were adopted would be an undue burden on management because it would be difficult to determine when and what needed to be disclosed.[89]

Finally, the Ninth Circuit panel in *Bins v. Exxon Co.* extended the duty to disclose beyond that required by all other circuits, holding that "once an employer-fiduciary seriously considers a proposal to implement a change in ERISA benefits, it has an affirmative duty to disclose information about the

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83. 919 F.2d 747 (D.C. Cir. 1990).

84. *Id.* at 751 (quoting RESTATEMENT (SECOND) OF TRUSTS § 173 (1959)). In contrast with the "retirement cases" with which this note is primarily concerned, *Eddy* dealt with an insurer's duty as a fiduciary under ERISA § 1104 to convey to a "lay beneficiary" correct and material information about his status and options when a group health policy is canceled. *Id.* at 750; *see also* Bixler v. Cent. Pa. Teamsters Health & Welfare Fund, 12 F.3d 1292, 1300 (3d Cir. 1993) (citing *Eddy*, the court held that an "ERISA fiduciary who is aware of the beneficiary's status and situation . . . has an obligation to convey complete and accurate information material to the beneficiary's circumstance . . . even if that information comprises elements about which the beneficiary has not specifically inquired"). Like the facts in *Eddy, Bixler* dealt with a beneficiary's claim for insurance benefits after her spouse had died. *See id.*

85. *See* Anweiler v. Am. Elec. Power Serv. Corp., 3 F.3d 986, 991-92 (7th Cir. 1993).

86. *See id.* at 991.

87. 81 F.3d 275, 278 (2d Cir. 1996).

88. *See id.* at 277.

89. *See id.* at 278.

proposal to all plan participants and beneficiaries to whom the employer knows, or has reason to know, that the information is material."[90] The facts in *Bins* are similar to those in *Fischer*. Bins, an employee of Exxon, was contemplating retirement but had heard rumors that a retirement incentive program was being considered. Bins asked his supervisor and others about such a program, but received no confirmation that it was under consideration. A few weeks after Bins retired, Exxon announced a reorganization plan and an enhanced retirement plan for early retirees.[91] Bins brought suit against Exxon, contending that under *Fischer,* once the company "began 'seriously considering' a proposal to offer enhanced benefits under the ERISA severance plan, it had not only a duty to respond accurately . . . to Bins' questions, but also an affirmative duty to provide information even in the absence of specific questions."[92] The district court applied the holding in *Fischer II* and held that although Exxon was seriously considering the incentive benefits before Bins retired, there was no breach of fiduciary duty because Bins did not ask about the benefits during the time that they were under consideration.[93]

The Ninth Circuit panel agreed that the *Fischer II* test was the appropriate test to determine when information becomes material, but disagreed with *Fischer II* to the extent it "characterizes the 'serious consideration' test as a compromise between an employer's role as a fiduciary . . . and its role as a business in seeking to maximize returns for its owners."[94] The court held that there was no room for compromise between these roles and that the "employer's need to operate efficiently as a business should play no role in determining when the employer has an obligation to communicate with employees about a proposed change in benefits."[95] The *Bins* panel indicated that "this view of the fiduciary's duty is compelled by the Supreme Court's decision in *Varity,* where the Court focused on ERISA's requirement that a fiduciary 'discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries.'"[96] The Ninth Circuit panel then reviewed the application of the "serious consideration test" by other circuits.[97] The court concluded, "The core inquiry must always be whether

90. 189 F.3d 929, 939 (9th Cir. 1999), *rev'd en banc* 220 F.3d 1042 (9th Cir. 2000).

91. *See id.* at 932.

92. *Id.* at 933.

93. *See id.*

94. *Id.* at 936. The Ninth Circuit en banc agreed that *Fischer II* is the appropriate test to determine materiality, but disagreed with the panel's rigid interpretation. *See Bins*, 220 F.3d at 1049-50.

95. *Bins*, 189 F.3d at 936.

96. *Id.* (quoting Varity Corp. v. Howe, 516 U.S. 489, 506 (1996)).

97. *See id.* at 936-37; *see also* Vartanian v. Monsanto Co., 131 F.3d 264, 272 (1st Cir. 1997) (holding that the plan change under consideration must affect a person in the plaintiff's position); Hockett v. Sun Co., Inc., 109 F.3d 1515, 1522-24 (10th Cir. 1997) (adopting the *Fischer II* test without modification); Ballone v. Eastman Kodak Co., 109 F.3d 117, 123 (2d Cir. 1997) (finding that serious consideration is only one "factor in the materiality inquiry"); Muse v. IBM, 103 F.3d 490, 494 (6th Cir. 1996) (holding that serious consideration occurs when a company "focuses on

the employer has violated its duty of loyalty to plan participants by failing to disclose material information, making misleading statements, or otherwise putting its business goals ahead of its fiduciary obligations."[98]

The *Bins* panel addressed the issue of an affirmative duty to disclose plan information by first recognizing a split in other circuits as to "whether an ERISA fiduciary has an affirmative duty to disclose a proposed change in benefits."[99] In its discussion, the court dismissed its earlier decision in *Acosta* that conflicting provisions of ERISA limit the affirmative duty to disclose, simply noting that the court was "aware of no conflicting provisions of ERISA that would undermine the affirmative duty of disclosure in this case."[100] The court concluded that there is an affirmative duty to disclose information regarding plan changes to plan participants and beneficiaries to whom the employer knows, or has reason to know, that the information is material.[101]

III. THE TENSION BETWEEN BUSINESS NEEDS AND FIDUCIARY REQUIREMENTS

A. Congressional Intent

Congress' original intent was to balance the needs of plan beneficiaries with the business requirements of employers.[102] This intent was clearly indicated by Senator Long's statement in the Congressional Record that stated, "[W]e know that new pension plans will not be adopted and that existing plans will not be expanded and liberalized if the costs are made overly burdensome, particularly for employers who generally foot most of the bill."[103] Since the enactment of ERISA in 1974, courts have repeatedly acknowledged this congressional sentiment. As early as 1985, in *Massachusetts Mutual Life Insurance Co. v. Russell*,[104] the Supreme Court noted that while Congress emphasized that ERISA's objective was to guarantee that employees receive their pension benefits, Congress was concerned that if the cost of complying with federal standards became too high, employers would be discouraged from providing

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a particular plan for a particular purpose").

98. *Bins*, 189 F.3d at 937.

99. *Id.* at 938. *See Vartanian*, 131 F.3d at 268 (declining to address affirmative duty issue); *Hockett*, 109 F.3d at 1525 n.4 (reserving the question of whether an affirmative "duty to disclose exists"); Pocchia v NYNEX Corp., 81 F.3d 275, 278 (2d Cir. 1996) (citing Stanton v. Gulf Oil Corp., 792 F.2d 432, 435 (4th Cir. 1986) (finding no duty to disclose plan changes until they are adopted)).

100. *Bins*, 189 F.3d at 938 n.5.

101. *See id.* at 939.

102. *See* H.R. REP. NO. 93-533, pt. 1, at 1 (1974), *reprinted in* 1974 U.S.C.C.A.N. 4639, WL 12549.

103. CONG. REC. 29,945 (1974) (statement of Sen. Russell Long).

104. 473 U.S. 134 (1985).

pension plans.[105] Again, in 1987, in *Pilot Life Insurance Co. v. Dedeaux*,[106] the Supreme Court recognized the need for balance, stating ERISA's "civil enforcement scheme . . . represents a careful balancing of the need for prompt and fair claims settlement procedures against the public interest in encouraging the formation of employee benefit plans."[107] The Supreme Court reaffirmed this view most recently in *Varity*.[108]

B. Business Needs Versus Fiduciary Responsibility

Prior to the enactment of ERISA, benefit plans were generally governed by the common law of trusts.[109] Congress intended that the fiduciary duties codified under ERISA continue to be informed by the common law of trusts.[110] Accordingly, the courts have looked to trust law to develop the plan administrator's fiduciary duties under ERISA.[111] However, as noted earlier, the *Varity* court instructed that the "courts must go on to ask whether, or to what extent, the language of the statute, its structure, or its purposes require departing from common-law trust requirements" in order to properly interpret ERISA's fiduciary duties.[112] Arguably, therefore, some departure from a literal application of trust law to ERISA is necessary in order to avoid the danger of upsetting the desired balance between businesses' and participants' needs.

The natural conflict that exists between a company's business needs and its fiduciary responsibility to plan participants is recognized by the *Fischer II* court, which noted that the "concept of 'serious consideration' recognizes and moderates the tension between an employee's right to information and an employer's need to operate on a day-to-day basis."[113] The dramatic difference in how the circuits view the need to strike a compromise between business

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105. *See id.* at 148.

106. 481 U.S. 41 (1987).

107. *Id.* at 54.

108. Varity Corp. v. Howe, 516 U.S. 489, 497 (1996) (noting that courts must take into account Congress' desire to balance the need for protection of benefits with its desire not to create a plan that is so costly in terms of administrative and litigation expenses that it discourages employers from offering benefit plans).

109. *See id.* at 496; *see also* Barry, *supra* note 5, at 735, 737-45 (reviewing the origins of the common law of trusts and its evolution in American courts). This article develops the view that the state of the law under ERISA is such that there is a mandatory duty for voluntary disclosure on the part of fiduciaries whenever information is "material to an employee's retirement decision." *Id.* at 761. This view, of course, is consistent with that of the Ninth Circuit in *Bins v. Exxon Co. U.S.A.*, 189 F.3d 929 (9th Cir. 1999), *rev'd en banc* 220 F.3d 1042 (9th Cir. 2000).

110. *See* H.R. REP. NO. 93-533, pt. 6, at 12 (1974), *reprinted in* 1974 U.S.C.C.A.N. 4639, WL 12549.

111. *See Varity Corp.*, 516 U.S. at 496.

112. *Id.* at 497.

113. Fischer v. Phila. Elec. Co., 96 F.3d 1533, 1539 (3d Cir. 1996), *cert. denied*, 520 U.S. 116 (1997).

realities and fiduciary duties under ERISA is demonstrated by comparing the view of the Third Circuit in *Fischer* with that of the Ninth Circuit panel in *Bins*:

> [W]e disagree with one aspect of Fischer .... In our view, there is no such thing as an appropriate compromise between these two roles. The employer, when acting as a fiduciary, has an undivided duty of loyalty to the participants and beneficiaries of the plan. The employer's need to operate efficiently as a business should play no role in determining when the employer has an obligation to communicate with employees about a proposed change in benefits.[114]

The *Bins* panel justified its approach by saying it is compelled by *Varity*, "where the Court focused on ERISA's requirement that a fiduciary 'discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries.'"[115] However, *Bins*' reliance on *Varity* is not supported contextually by *Varity*. First, the statement the panel in *Bins* finds so compelling is merely a recitation by the *Varity* court of the common law principle of fiduciary duty as stated in the statute.[116] Moreover, *Varity* is distinguishable because the employer's acts in that case were more egregious.[117] The *Varity* employees lost all of their benefits because of the employer's misrepresentation.[118] The employee in *Bins*, however, received his promised benefits. The only question was whether he should have received more.[119]

Other courts have adopted a more measured interpretation of *Varity*. In *Vartanian v. Monsanto*,[120] for example, the First Circuit interpreted *Varity* in a less aggressive fashion, noting specifically the Supreme Court's mention in *Varity* of the need to temper application of trust principles with a "scrupulous regard for the delicate balance Congress struck in enacting ERISA."[121] The facts in *Vartanian* were similar to those in *Bins*. The employee in *Vartanian* heard rumors of a possible early retirement buyout, asked his superiors about it, and was told by them that they were unaware of any such plan. Shortly after he retired, a buyout plan was announced.[122] Applying the *Fischer II* test, the *Vartanian* court held that the plan was not under serious consideration when the employee asked about it.[123] In arriving at its decision, the *Vartanian* court specifically declined to follow the more flexible standard of affirmative

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114. Bins v. Exxon Co. U.S.A., 189 F.3d 929, 936, *rev'd en banc* 220 F.3d 1042 (9th Cir. 2000) (citing *Varity Corp.*, 516 U.S. at 506).

115. *Id.* (quoting *Varity Corp.*, 516 U.S. at 506).

116. *See* 29 U.S.C. § 1104(a) (1999).

117. *See Varity Corp.*, 516 U.S. at 493-94 (employer made blatantly false misrepresentations to plan participants).

118. *See id.* at 494.

119. *See Bins*, 189 F.3d at 933-34.

120. 131 F.3d 264 (1st Cir. 1997).

121. *Id.* at 269.

122. *See id.* at 266-67.

123. *See id.* at 272.

disclosure urged by the employee.[124]

In general, courts have considered the needs of business in a considerably more sympathetic fashion than that of the *Bins* panel. In *Pocchia,* for example, the court noted that if disclosure was required prior to adoption of a plan, a business would not be able to develop a strategy for reducing its workforce because if "fiduciaries were required to disclose such a business strategy, it would necessarily fail. Employees simply would not leave if they were informed that improved benefits were planned if workforce reductions were insufficient."[125] In *Pocchia*, an employee claimed that the company breached its fiduciary duty under ERISA because it did not inform him at the time of his resignation that a decision had already been made to implement an early retirement incentive plan. The employee had received a lump sum payment upon his resignation, and the new plan was not announced until seven months later.[126] The *Pocchia* court believed that mandatory disclosure prior to adoption of a plan would cause confusion for participants and "unduly burden management, which would be faced with continuous uncertainty as to what to disclose and when to disclose it."[127] In reaching its decision, the *Pocchia* court joined the courts in *Porto*, *Acosta*, and *Vartanian* in noting, "Congress' main purpose in imposing a disclosure requirement on ERISA fiduciaries was to ensure that 'employees [would have] sufficient information and data to enable them to know whether the plan was financially sound and being administered as intended.'"[128]

Bettis v. Thompson,[129] a decision diametrically opposed to *Bins*, ironically involved the same employer:

> The idea of imposing a fiduciary duty affirmatively not to mislead a beneficiary once a company has begun to take a plan into serious consideration is unworkable. . . .
>
> . . . .
>
> The only duty a corporation has to employees is accurately to explain the current state of affairs about the pension[s] plan then in effect.
>
> . . . ERISA does not create a duty that requires the disclosure of plan amendments before they are put into effect. A different rule would cause employers to be reluctant to improve benefits because everyone who retired just before a change could sue.[130]

Finally, the *Varity* court itself recognized the necessity of balancing the needs of business with those of employees.[131] The *Varity* court also appears to

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124. *See id.* at 268.

125. Pocchia v. NYNEX Corp., 81 F.3d 275, 289 (2d Cir. 1996).

126. *See id.*

127. *Id.*

128. *Id.* at 279 (citing H.R. REP. NO. 93-533, pt. 6 (1974)).

129. Bettis v. Thompson, 932 F. Supp. 173, 175-76 (S.D. Tex. 1996) (citations omitted).

130. *Id.* at 175-76.

131. *See* Varity Corp. v. Howe, 516 U.S. 489, 497 (1996).

acknowledge that its holding concerning fiduciary responsibility was intended to be quite narrow and based on the specific facts of that case.[132]

C. The Changing Workplace

Tension between the needs of business and plan participants has grown in recent years, in part because of changing conditions in the workplace. Businesses must reduce costs and attract and retain key workers to remain competitive.[133] Another factor driving change in pension plan offerings is the mobility of today's work force. Unlike workers of the 1960s and 1970s, today's workers rarely spend an entire career at the same company. Employees who frequently switch jobs receive little from defined benefit plans where the size of the benefit is determined by length of service and final average pay.[134] The mobility of employees also creates the need for companies to find new ways to attract and retain workers.[135] Finally, changes involving corporate structure such as mergers, business sales, and the creation of joint ventures have dramatically affected the pension industry.[136]

Businesses responded to the changing workplace in part by introducing benefit plans more attuned to the needs of younger, more mobile workers. In 1999, in defense of a controversial decision to switch from a traditional final average pay pension plan to a cash balance plan, IBM executives noted that "[seventy-five] percent of its high-tech competitors, such as Microsoft Corp. . . . don't even offer pensions and have more money for other expenses."[137] IBM,

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132. *See id.* at 503 ("We conclude, therefore, that the factual context in which the statements were made, combined with the plan-related nature of the activity, engaged in by those who had plan-related authority to do so, together provide sufficient support for the District Court's legal conclusion that Varity was acting as a fiduciary."); *see also id.* at 538 ("I do not read the Court's opinion to extend fiduciary liability to all instances in which the Court's rationale would logically apply.") (Thomas, J., dissenting).

133. *See* Curt Anderson, *Congress, Feds Examine Pension Plan*, YAHOO NEWS, Sept. 22, 1999, *available at* http://dailynews.yahoo.com/h/cp/19990922/bs/pensions_older_workers_3.html.

134. *See* PATRICK J. PURCELL, CONG. RESEARCH SERV., PENSION ISSUES: CASH BALANCE PLANS (1999).

135. *See* Stephen Franklin, *A Corporate Pension Headache; How May IBM Employees Spell Relief? U-N-I-O-N*, CHI. TRIB., Aug. 29, 1999, at C1.

136. *See Pension Bills: Hearings Before the Sen. Fin. Comm. on Pension Reform Legislation*, 106th Cong. (1999) [hereinafter *Pension Bills*] (statement of Scott J. Macey, senior counsel, American Society of Actuaries) (explaining that such changes accounted for forty percent of the new plans set up in 1995 by one large pension manager).

137. Anderson, *supra* note 133 (explaining that defined benefit pension plan provides the employee a fixed monthly income based on years of service and income level the last several years of employment). *See also* 29 U.S.C. § 1002(34) (1999); *Pension Bills*, *supra* note 136 (statement of Patrick J. Purcell, Specialist in Social Legislation, Congressional Research Service). A defined contribution plan is a pension plan that "provides for an individual account for each participant" and where benefits are "based solely on the amount contributed to the participant's account." *Id.*

therefore, changed its overall compensation package to compete and to attract the people necessary for its success.[138] IBM's change to a cash balance plan generated a major uproar primarily among its older employees, who in turn succeeded in attracting the attention of Congress.[139]

According to one industry source, the main reasons why employers convert a defined benefit plan to a cash balance plan are to reduce costs, remain competitive, and attract younger workers.[140] Younger workers generally support cash balance plans because benefits are accumulated faster than under traditional defined benefits plans.[141] Following a conversion, however, senior workers may find that the change from defined benefit plans to cash value plans lowers their future benefit accruals because long-time workers may not accrue additional benefits until they "wear away" the old benefit.[142] The conversion may force older workers to work additional years before the cash-balance account exceeds the level of benefits that had accrued under the old plan.[143]

Most cash balance conversions, however, do not save the company money because most companies that convert to such plans provide enhancements to benefits at the same time the conversion takes place.[144] Critics of cash balance plans, however, claim that cash balance sponsors fail to disclose changes to benefit computation methods and do not provide enough information about the plan amendments.[145] "The issue of disclosure—how far companies should go to make sure their employees are informed about plan amendments that replace a traditional defined benefit plan arrangement with a cash balance plan arrangement—is one of the more contentious topics surrounding the debate over cash balance conversions."[146] Although both employees and industry representatives agree on the need for disclosure, the issues of when and how

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A popular example of a defined contribution plan is a 401(k) plan. A cash-balance plan, sometimes referred to as a "hybrid," is a defined benefit plan that has characteristics of a defined contribution plan. An employer contributes a percentage of pay into an employee 'account' and credits interest to the account. *Id.* at 1.

138. *See Pension Bills*, *supra* note 136.

139. *See* Congel & White, *supra* note 16, at D3.

140. *See* Colleen T. Congel, *Advisory Council: Cash Balance Plan Conversions Focus of ERISA Council Working Group*, BNA PENSION & BENEFITS DAILY NEWS, Apr. 9, 1999, at D3.

141. *See* Colleen T. Congel, *Plans Draw Both Praise, Criticism*, BNA PENSION & BENEFITS DAILY NEWS, Mar. 5, 1999, at D9; *see also* Vivian Marino, *Old Pensions Put Out to Pasture,* TOPEKA CAP.-J., July 18, 1999, at C1.

142. *See* Congel, *supra* note 141, at D9.

143. *See id.*

144. *See Minimal Cost Savings Found in Cash Balance Conversions*, WATSON WYATT WORLDWIDE, Feb. 21, 2000, *available at* http://www.watsonwyatt.com/homepage/us/new/ pres_rel/ feb00/cashbal.htm (study done by Watson Wyatt found average employer savings of only 1.4% during plan conversions).

145. *See* Congel, *supra* note 140, at D3.

146. Congel & White, *supra* note 16, at D3.

much plan participants need to be told are the focus of much debate.[147]

A review of the debate surrounding proposed legislation relating to cash balance plan disclosure requirements suggests that Congress remains concerned about the tension between plan participants and business needs. Legislation has been proposed that would substantially expand ERISA's notice requirements, but it has faced strong opposition because it would result in significantly increased administrative costs to employers.[148] One such disclosure bill, introduced by former New York Senator Moynihan, would require that companies disclose to employees how a conversion to a cash balance plan would affect them and mandate that each employee be given a "personal statement comparing benefits under the old and new plans."[149] Employers oppose Moynihan's bill because of the cost of providing individual disclosure statements to each plan participant and note that "[a]ll pension plans are voluntary . . . and companies have the right to make appropriate changes to their business plans."[150] Employers argue that it is sufficient to provide employees with hypothetical examples to illustrate the effect of the change.[151] While Congress tries to decide what to do in terms of disclosure, "corporate America is sending a clear message: Without varied benefit options, more companies will opt not to offer pensions."[152]

D. Net Effect on Pension Plans

Beginning in the 1980s market pressures, combined with the burdensome requirements of ERISA, caused many companies to terminate traditional pension plans.[153] Commentators have surmised that the traditional defined benefit pension plans may not be compatible with the "flexible labour market of the American economy's so-called 'New Era.'"[154] For example, "400 to 600 mid and large sized companies, including [twenty-two] of the Fortune 100 companies, have adopted cash balance plans covering approximately [seven] million people."[155] The overall reduction in defined benefit plans, along with the conversion to alternate plans such as cash balance plans, is a signal that the requirements of ERISA and additional court-imposed regulations are too burdensome for businesses in today's marketplace.

Although ERISA has protected promised worker benefits for plans that are in effect, the reduction in the number of pension plans is a clear indication of the failure to achieve Congress' intended balance between business needs and

147. *See* Congel, *supra* note 141, at D9; *see also* Anderson, *supra* note 133.

148. *See* Congel, *supra* note 140, at D3.

149. Marino, *supra* note 141, at C1.

150. *Id.*

151. *See Pension Bills*, *supra* note 136.

152. Anderson, *supra* note 133.

153. *See* Congel & White, *supra* note 16, at D3.

154. Richard A. Hawkins, *The Promise of Private Pensions: The First Hundred Years*, BUS. HIST., July 1998, at 157.

155. Congel, *supra* note 141, at D9.

protection of benefits for plan participants.[156] Representative Rob Portman recently stressed the need to provide relief from regulatory burden as an incentive for business owners to offer retirement plans to their employees.[157] In response to opponents of his pension reform legislation, Portman commented, "I sort of view pensions, particularly defined benefit plans, as kind of like the Titanic sinking and someone saying, 'gee, I'm worried there might be an officer in the lifeboat, so we don't want to put the lifeboats out.'"[158]

IV. Analysis

A premise of this Note is that the amount of disclosure required by ERISA should not be the same for all circumstances, but rather should be determined by the factual context of each case. Two common fact patterns emerge in most disclosure cases that reach the circuit courts. The first fact pattern occurs where an employee is not provided complete or correct information concerning a medical or insurance plan covered by ERISA.[159] If the need for a fiduciary duty to disclose information is viewed on a continuum, it is strongest in these cases. The need is strongest because the statutory requirements of ERISA clearly justify an interpretation by the courts that an employer has an affirmative duty to disclose complete information to plan participants to protect their existing rights and benefits.[160] The second typical fact pattern occurs when an employee opts to retire or resign his position and learns thereafter that delaying the termination would have resulted in an enhanced retirement package.[161] In these cases, ERISA's fiduciary requirements do not dictate an affirmative duty to disclose and no intention of Congress to promote such a requirement can be inferred from the legislative history.[162] This view, of course, is contrary to the Ninth Circuit panel's holding in *Bins*, as well as to arguments presented by other commentators regarding the ERISA disclosure issue.[163]

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156. *See ERISA's Requiem*, *supra* note 16, at 10 (noting benefits promised by defined benefit plans are today more secure than before ERISA, but that the number of such plans has dropped dramatically, and is still dropping).

157. *See* Elizabeth A. White, *Retirement Policy: Portman, Cardin Bill Gets Positive Airing at Hearing on Legislation's ERISA Provisions*, BNA PENSIONS & BENEFITS DAILY, July 1, 1999, at 16.

158. *Id.*

159. *See, e.g.*, Eddy v. Colonial Life Ins. Co. of Am., 919 F.2d 747, 750 (D.C. Cir. 1990).

160. *See* 29 U.S.C. § 1104 (1999).

161. *See, e.g.*, Bins v. Exxon Co. U.S.A., 189 F.3d 929, 931 (9th Cir. 1999), *rev'd en banc* 220 F.3d 1042 (9th Cir. 2000).

162. *See* 29 U.S.C. § 1104 (1999); *see also* H.R. REP. NO. 93-533, pt. 1, at 1 (1974), *reprinted in* 1974 U.S.C.C.A.N. 4639, 1973 WL 12549.

163. *See Bins*, 189 F.3d at 939; *see also* Barry, *supra* note 5, at 761 (the "state of the law has arrived to a point where voluntary disclosure is mandatory"); Jensen, *supra* note 4, at 159 ("Courts should continue along the path of several recent circuit and district court decisions toward requiring increased accountability and disclosure from ERISA employers . . . .").

The panel's approach in *Bins* would impose an affirmative duty on employers to voluntarily disclose information to participants with no apparent reservation. There is nothing in ERISA however that demands that an employer's fiduciary duty rise to the level requested by the panel in *Bins*, nor was it ever the intent of Congress that ERISA create such a duty. Rather, the sponsors of ERISA knew that to place too heavy a burden on employers might result in companies ceasing to provide plans, thus thwarting the objective of having more workers covered by pension plans.[164]

The panel's holding in *Bins* represents a culmination of disclosure decisions made by the courts in the years since the enactment of ERISA. In arriving at its sweeping holding, the Ninth Circuit panel reviewed the rulings of the most significant circuit court decisions dealing with the disclosure issue.[165] For that reason, as well as the fact that the arguments of the panel in *Bins* will likely be reflected in future disclosure cases, it serves as a logical and convenient vehicle for analysis of ERISA's fiduciary and disclosure requirements.

A. Fiduciary Duty

The Ninth Circuit panel in *Bins* agreed with the *Fischer II* "serious consideration test" as to when "information about a proposed change in benefits becomes material."[166] The panel disagreed, however, with the *Fischer II* characterization that the test is a compromise between an "employer's role as a fiduciary . . . and its role as a business."[167] In the panel's view, there is no room for compromise between these roles, and business considerations cannot be considered with regard to communications to employees about proposed changes in benefits.[168]

As noted earlier, the *Bins* panel believed its view was compelled by *Varity*. *Bins* adopted the *Varity* holding that "making intentional misrepresentations about the future of plan benefits is an act of plan administration" and therefore a fiduciary act, because to deceive a plan's beneficiaries in order to save the employer money is not acting "solely in the interests of the participants and beneficiaries."[169] However, in coming to its conclusion that *Varity's* interpretation of ERISA's fiduciary duty compels an affirmative duty to disclose future plan benefits, the *Bins* panel suggested a very broad and expansive

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164. *See* H.R. REP. NO. 93-533, pt. 1, at 1 (1974), *reprinted in* 1974 U.S.C.C.A.N. 4639, 1973 WL 12549. *But see* Lorraine A. Schmall, *Keeping Employer Promises when Relational Incentives No Longer Pertain: "Right Sizing" and Employee Benefits*, 68 GEO. WASH. L. REV. 276, 279 (2000) (claiming the complexity of ERISA has not overly deterred employees from creating pension plans). That claim does not square, however, with the significant drop in defined benefit plans that has occurred in the years since ERISA was enacted.

165. *See Bins*, 189 F.3d at 936-39.

166. *Id.* at 936.

167. *Id.*

168. *See id.*

169. *Id.*

interpretation of the fiduciary duty outlined in *Varity*.[170]

Several objections can be raised to the *Bins* panel's view of an employer's fiduciary duty under ERISA. First, ERISA itself does not mandate the standard of fiduciary duty prescribed in *Bins*.[171] Rather, a reading of the fiduciary duty requirements set forth in ERISA demonstrates that the duty is tied very closely to the protection of existing plan benefits.[172] Second, the *Bins* view disregards the intent of ERISA's sponsors to balance the needs of businesses and employees as outlined in the legislative history.[173] Finally, the Supreme Court's decision in *Varity* does not dictate the result reached by the *Bins* court.

In *Varity*, information was communicated to employees to fraudulently induce them to accept a transfer to another company that the fiduciary knew was insolvent, rather than to help them determine whether or not to stay in a plan.[174] The employer's actions were an affirmative misrepresentation and a per se violation of ERISA's "duty to act solely in the interests of participants."[175] The decision therefore falls squarely within the purview of ERISA.[176]

However, nothing in *Varity* justifies the unprecedented broad application of this duty in a fact pattern such as that in *Bins*. The employee in *Bins* had already made the decision to retire, and there was no question about the benefits due him or about whether he would be paid those benefits.[177] Bins was simply trying to determine whether a "better deal" might be forthcoming if he delayed his retirement. His position bears little resemblance to that of the plaintiffs in *Varity*, or to that in other cases where an employee seeks information to assist in making benefit decisions related to benefits already in existence.[178] Simply stated, in one case a participant is attempting to protect his existing rights to benefits, which falls within the purposes of ERISA, and in the other case the participant is trying to use the Act to gain a greater future benefit than he has neither earned nor was promised.

The *Bins* court's view of business needs versus disclosure requirements is in direct conflict with the Supreme Court and most other circuits' recognition of Congress' intent to balance the tensions between business and the protection of

170. *See id.*

171. *See* Acosta v. Pac. Enters., 950 F.2d 611 (9th Cir. 1991); Porto v. Armco, Inc., 825 F.2d 1274, 1276 (8th Cir. 1987).

172. *See* 29 U.S.C. § 1104 (1999).

173. *See* H.R. REP. NO. 93-533, pt. 1, at 1 (1974), *reprinted in* 1974 U.S.C.C.A.N. 4639, 1973 WL 12549.

174. *See* Varity Corp. v. Howe, 516 U.S. 489, 494 (1996).

175. *Id.* at 494. *See also* 29 U.S.C. § 1104 (1999).

176. *See* 29 U.S.C. § 1001 (1999); Dade v. N. Am. Philips Corp., 68 F.3d 1558, 1562 (3d Cir. 1995) ("Congress' chief purpose in enacting [ERISA] was to ensure workers receive promised pension benefits. . . .").

177. *See* Bins v. Exxon Co. U.S.A., 189 F.3d 929, 931-33 (9th Cir. 1999), *rev'd en banc* 220 F.3d 1042 (9th Cir. 2000).

178. *See generally* Bixler v. Cent. Pa. Teamsters Health & Welfare Fund, 12 F.3d 1292, 1300 (3d Cir. 1993); Eddy v. Colonial Life Ins. Co., 919 F.2d 747, 750 (D.C. Cir. 1990).

plan participants.[179] In fact, the *Varity* court, which the *Bins* court claims compels its view, recognized that:

> [C]ourts may have to take account of competing congressional purposes, such as Congress' desire to offer employees enhanced protection for their benefits, on the one hand, and, on the other, its desire not to create a system that is so complex that administrative costs, or litigation expenses, unduly discourage employers from offering welfare benefit plans in the first place.[180]

Accordingly, it does not seem that either *Varity* or ERISA itself compels the expansive application of fiduciary duty of disclosure suggested by the *Bins* panel.

B. *Affirmative Duty to Disclose*

After reviewing the disclosure decisions of other circuits that have addressed the *Fischer II* "serious consideration test," the *Bins* panel summarized its view of the test: "The core inquiry must always be whether the employer has violated its duty of loyalty to plan participants by failing to disclose material information, making misleading statements, or *otherwise putting its business goals ahead of its fiduciary obligations*."[181] The panel then turned to the issue of whether there is an affirmative duty to disclose information, even when a beneficiary has made no request for information.[182]

The *Bins* panel began by summarizing prior decisions in which courts have indicated that an affirmative duty to volunteer information exists.[183] As noted by the court, however, all of the cases cited dealt with considerably different circumstances than did *Bins*.[184] The panel's inquiry then focused on other circuit

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179. *See* Varity Corp. v. Howe, 516 U.S. 489, 497 (1996) (discussing competing Congressional purposes); Vartanian v. Monsanto Co., 131 F.3d 264, 268 (1st Cir. 1997) (tension often rises and is in "many respects, an inherent feature of ERISA"); Hockett v. Sun Co., 109 F.3d 1515, 1522 (10th Cir. 1997) (agreeing with the *Fischer II* comment on the tension between employer and employee rights); Muse v. IBM, 103 F.3d 490, 494 (6th Cir. 1996) (discussing disclosure versus burden on management with respect to what and when to disclose); Fischer v. Phila. Elec. Co., 96 F.3d 1533, 1539 (3d Cir. 1996) (stating their serious consideration test "moderates the tension between an employee's right to information and an employer's need to operate on a day to day basis"), *cert. denied*, 520 U.S. 1116 (1997).

180. *Varity*, 516 U.S. at 497.

181. *Bins*, 189 F.3d at 937 (emphasis added).

182. *See id.* at 938.

183. *See id.*

184. *See id.* In one case the fiduciary did not conduct an investigation or alert plan participants concerning his suspicions that plan funds were being mismanaged. *See* Barker v. Am. Mobil Power Corp., 64 F.3d 1397, 1403 (9th Cir. 1995). In a second case, the fiduciary withheld information about potential negative tax consequences of early retirement. *See* Farr v. U.S. W. Communications, Inc., 151 F.3d 908, 914 (9th Cir. 1998), *as amended*, 179 F.3d 1252 (9th Cir. 1999). A third case suggested an affirmative duty to inform when silence might be harmful. *See*

decisions about whether ERISA compels an affirmative duty for fiduciaries to disclose proposed changes in benefits. Although a split was noted in the circuits, the *Bins* court concluded that, once a "fiduciary has material information relevant to a plan participant or beneficiary, it must provide that information whether or not it is asked a question."[185]

The Ninth Circuit panel could see no reason why there should be a duty to supply information when a participant asks, as the "serious consideration test" requires, but not supply information if the participant does not think to ask.[186] In the court's view, there was no justification for rewarding those lucky enough to ask, but allowing employers to remain silent with respect to those who did not take such initiative.[187]

The *Bins* panel realized the problems its holding of an affirmative duty to disclose may cause employers but stated that it did not believe the affirmative duty it placed on plan fiduciaries would be such a heavy burden that it would discourage companies from offering benefit plans or from enhancing them to induce early retirements.[188] This view, of course, is diametrically opposed to that of the Second Circuit in *Pocchia*.[189] The *Pocchia* court recognized that insisting on voluntary disclosure prior to adoption of a new plan would likely confuse beneficiaries, unduly burden management, and "impair the achievement of legitimate business goals."[190] Significantly, the *Pocchia* court went on to note that a business strategy to induce early retirements with plan incentives would fail if participants were "informed that improved benefits were planned if workforce reductions were insufficient."[191]

C. Discussion

The view espoused by this Note is that the Second Circuit in *Pocchia* has formulated the most appropriate rule with respect to a fiduciary-employer disclosure requirement, at least in early retirement incentive cases.[192] As the *Pocchia* court notes:

> [S]uch a bright line rule protects the interests of beneficiaries, who will receive information at the earliest point at which their rights can possibly be affected, as well as the interests of fiduciaries, who will be required

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Bixler v. Cent. Pa. Teamsters Health & Welfare Fund, 12 F.3d 1292, 1300 (3d Cir. 1993).

185. *Bins*, 189 F.3d at 939. *But see* Vartanian v. Monsanto Co., 131 F.3d 264, 268 (1st Cir. 1997) (declining to address the issue of an affirmative duty to disclose); Hockett v. Sun Co. Inc., 109 F.3d 1515, 1525 (10th Cir. 1997) (reserving the question on an affirmative duty); Pocchia v. NYNEX Corp., 81 F.3d 275 (2d Cir. 1996) (holding no duty to disclose until a plan is amended).

186. *See Bins*, 189 F.3d at 939.

187. *See id.*

188. *See id.*

189. *See* Pocchia v. NYNEX Corp., 81 F.3d 275, 279 (2d Cir. 1996).

190. *Id.* at 278.

191. *Id.* at 279.

192. *See id.* at 278 (holding no duty to disclose until plan changes have been adopted).

> to provide information only at the point at which it becomes complete and accurate.[193]

This decision demonstrates an understanding of the tension between employer and beneficiary interests which was recognized by Congress at the inception of ERISA. It is also directly in line with the stated intent of ERISA to protect participant benefits.[194] Employees will receive all the benefits promised. Employers, meanwhile, can operate their businesses and plan business strategy in an efficient manner without wondering whether they have crossed the point at which they must notify employees of a potential change in plan benefits.

The *Bins* panel, on the other hand, ignores any need for a balance between employers and plan participants and creates a climate that will almost assuredly result in a net decrease in pension plans or benefits thereunder. In effect, the panel shifts an approach that was intended to be balanced to one that significantly favors employees. While ERISA was intended to protect employees' retirement benefits and to provide for administration of plans at a reasonable cost,[195] the panel's ruling in *Bins* essentially turns ERISA into a tool for employees to leverage maximum financial benefits from employers regardless of the circumstances and no matter what the costs. It allows employees "to have their cake and eat it too."[196]

An affirmative duty to disclose information concerning the possibility of increased benefits in this context is unrealistic, and it ignores the fiduciary responsibilities corporate officers and directors have to their shareholders, many of whom are also employees. For example, a business may be considering an early retirement incentive as part of a merger discussion or as part of a corporate reorganization or cost reduction. A requirement on employers to disclose information with respect to potential plan changes prior to announcement of the event prompting the changes would undermine the company's strategy and could easily result in a negative impact on company stakeholders, employees and shareholders alike. Disclosure of such information might cause a company's stock price to change, thus affecting the cost of a merger, or it could inspire competitive actions that would derail the merger altogether.

A very likely result of an affirmative duty to disclose such as the *Bins* panel proposed would be an accelerated reduction in the number of benefit plans offered by employers, at least in part, because of the uncertainty such a requirement will create among businesses. There is no requirement that companies offer pension plans.[197] In fact, that is one reason why Congress and

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193. *Id.* at 279.

194. *See* 29 U.S.C. § 1104 (1999).

195. *See id.* § 1001.

196. For example, an employee plans to retire and is fully informed of his or her retirement benefits when the decision is made, but believes that he or she perhaps could squeeze a bit more out of the company or the plan.

197. *See* H.R. REP. NO. 93-533, pt. 1, at 1 (1974), *reprinted in* 1974 U.S.C.C.A.N. 4639, 1973 WL 12549.

the courts have attempted to use caution in the implementation and interpretation of ERISA. The concern remains that placing too extensive a burden on employers will result in a reduction in the number of plans offered. Further, since an employer has no legal obligation to provide a retirement plan, the employer has no obligation to increase the payments under a plan that already exists.[198] Why then, should an employer be obligated to divulge business strategies by telling employees they might receive more if they stay longer?

As *Pocchia* suggests,[199] employees would have no incentive to retire under those circumstances. Also, in some cases, the additional cost to the employer may well exacerbate a company's already deteriorating financial position, thus jeopardizing the employment position of all its workers. Imposing the requirement suggested by *Bins* may also work to employees' disfavor in another way. One reason for offering early retirement incentives is to reduce employment in a less egregious manner than simply terminating employees. Decisions like that of the *Bins* panel that increase the burden on employers in this situation could well lead to companies exercising the undesirable option of simply terminating employees in order to achieve their goals. In that event, neither those who would like to leave early nor those who would like to stay would be satisfied.

Bins suggests there is no reason why some employees (those who ask) should be lucky enough to receive additional incentive benefits versus those who do not ask. That argument is eliminated if *Pocchia* is adopted, because under that court's bright line test there is no need to disclose such information to any employee.[200] Whether employees ask or not, the only duty is not to mislead or misinform them.[201] Even if that were not the case, however, luck is not the issue. For example, if an early retirement incentive program is introduced, it generally requires participants to be fifty-five or older. Many of those who are near the cut-off age would also consider themselves "unlucky" because they were not quite old enough to take advantage of the incentives. Of course, it would be ridiculous to require the company to lower the age level so the "unlucky" ones who are only fifty-four are covered. There simply must be a definite cut-off level for age and for disclosure requirements.

Businesses generally operate as rational economic entities. They will attempt to operate in an efficient manner in order to remain profitable and competitive. In their attempt to control costs, they will try to reduce uncertainty to the extent possible in the operation of their businesses. A disclosure requirement such as that suggested by *Bins* would increase both uncertainty and the cost burden on companies. An employer's reaction may very well be to eliminate plans affected by the court's ruling, or in the case of new enterprises, to refrain from adopting such plans in the first place. The net effect, therefore, may well be the

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198. *See id.*

199. *See* Pocchia v. NYNEX Corp., 81 F.3d 275 (2d Cir. 1996); *see also supra* text accompanying note 125.

200. *See Pocchia*, 81 F.3d at 279.

201. *See id.* at 278.

elimination of the need for such disclosure as the benefit plans that fall under its aegis are terminated.

The circuit court decisions with respect to disclosure requirements under ERISA diverged in opinion prior to the Ninth Circuit panel's ruling in *Bins*, but an affirmative duty to disclose as suggested by the panel would significantly widen the gap.[202] It is important that there be continuity in disclosure requirements since a substantial number of employers who are affected by such rulings engage in business activities and have employees in multiple states. As a result, these businesses would be essentially required to conform with any circuit holding that is similar to that in *Bins*, as unhappy plan participants would almost certainly file complaints in that jurisdiction whenever possible. The Supreme Court specifically declined to address the issue of the serious consideration test in *Varity* and denied certiorari in *Pocchia* and *Fischer*, thus allowing the circuit courts to develop the law in this area.[203] The divergence in circuit court opinions has now reached the point, however, that the Supreme Court should review a case with a similar fact pattern to *Bin* that applies an "affirmative duty to disclose" requirement. It is important that this be resolved in order to establish continuity in the circuits so that both employers and participants know their rights on this issue.

CONCLUSION

An affirmative duty to disclose as suggested by the *Bins* panel obliterates the intent of Congress, which was recognized by the *Varity* court to balance business requirements with the protection of beneficiaries. This tilting of the scales would likely quicken the exodus of employers from those still offering defined benefit plans. The net effect will be a reduction in the number of employees covered by such plans.

If the Supreme Court addresses the "affirmative duty to disclose" issue, it should conclude that the type of disclosure requirements suggested by the *Bins* panel, at least in the context of early retirement cases, are invalid. The panel's ruling clearly goes beyond what Congress ever intended in adopting ERISA. The employee considering an early retirement decision is making a voluntary choice as to his or her retirement date. The employee is not required to retire but simply desires to do so. There is no legitimate reason an employer should be required to disturb its business strategies to inform the prospective retiree that an improved plan might be forthcoming if he or she delays retirement. The requirement to do so exceeds the protection intended by Congress and, in effect, forces the company to increase an employee's benefits in the case of a voluntary retirement.

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202. *See* Bins v. Exxon Co. U.S.A., 189 F.3d 929, 939 (9th Cir. 1999), *rev'd en banc* 220 F.3d 1042 (9th Cir. 2000). *But cf. Pocchia*, 81 F.3d at 279; Fischer v. Phila. Elec. Co., 96 F.3d 1530 (3d Cir. 1996), *cert. denied*, 520 U.S. 1116 (1997).

203. *See* Pocchia v. NYNEX Corp., 517 U.S. 931 (1996); Varity Corp. v. Howe, 516 U.S. 489, 506 (1996); *Fischer*, 96 F.3d at 1530.

Finally, businesses seek as much certainty as possible in conducting their affairs. In the context of early retirement cases such as *Bins*, the superior option is the Second Circuit's bright line rule established in *Pocchia* that there is no duty to inform until plan changes have been adopted.[204] This option enables all parties to have a degree of certainty with respect to ERISA administration, yet beneficiaries are still protected from misleading statements or misrepresentations on the part of fiduciaries. Concurrently, it fulfills the purpose of ERISA that existing plan benefits be protected. The certainty and reasonableness created by the *Pocchia* rule would therefore encourage companies to provide pension benefits and help fulfill Congress' intent that more workers be covered by retirement plans.

204. *See Pocchia*, 81 F.3d at 278.